NATIONAL TAX JOURNAL

Volume V, No. 4 December 1952

(Continued inside cover)

PUBLISHED QUARTERLY BY THE NATIONAL TAX ASSOCIATION

NATIONAL TAX JOURNAL

PUBLISHED QUARTERLY BY THE NATIONAL TAX ASSOCIATION

Yearly subscription, $5.00
(To members included in annual dues)
Single copy, $1.50

Publication office:
111 East Chestnut Street
Lancaster, Pennsylvania

CONTENTS

(*Continued from front cover*)

Subscriptions and reprint requests should be sent to Ronald B. Welch, Secretary, National Tax Association, P. O. Box 1799, Sacramento 8, California. Applications for membership and notices of change of address should also be addressed to the Secretary. Complaints of nonreceipt of publications cannot be satisfied unless filed with the Secretary within sixty days of publication; thereafter, regular prices will be charged.

Communications for the editor, manuscripts, and books for review should be sent to J. Keith Butters, Editor, NATIONAL TAX JOURNAL, Soldiers Field, Boston 63, Massachusetts.

Opinions expressed in the JOURNAL are not to be construed as those of the National Tax Association unless expressly so stated.

Entered as second-class matter April 29, 1948, at the post office at Lancaster, Pennsylvania, under the Act of March 3, 1879.

National Tax Journal

Volume V, No. 4 December 1952

THE CORPORATE INCOME TAX: A RE-EVALUATION

RICHARD E. SLITOR *

Introduction and Background

IN SPITE of intensive study in the past decade, the corporate tax structure remains one of the most difficult and controversial areas in American public finance. Current attitudes toward the corporate tax are still dominated by the postwar discussions of double taxation of dividends, related "unneutralities," and alternative proposals for structural reform through integration of the individual and corporate income levies. The recent comprehensive treatment by Goode [1] made an important contribution toward shifting this emphasis and stimulating thought along new, constructive channels.

Both before and after Korea, the corporation income tax has not only continued to be the instrument of raising large amounts of revenue, but has also played a major role in economic stabilization. Double taxation and related issues have thus entered a period of partial abeyance, although some type of integration is occasionally advocated as an appropriate part of fiscal policy for high-level mobilization.[2] The controversy may appear merely to be in a state of suspended animation, pending the attainment of more normal conditions. However, there are indications that new perspectives will modify the approach to the question when more active discussion is renewed. The recent profits experience and continuing conceptual developments in the fields of macroeconomic analysis and the theory of the firm will require substantial reorientation of past thinking.

With this general justification, the present article re-examines some of the broad questions relating to the economic impact of the corporate income tax and its role in the revenue system in the light of current trends of analysis. Among the specific topics covered are the questions of tax rates and incentives, wasteful business expenditures, the neutrality doctrine and corporate tax unneutralities, double taxation of dividends, shifting and incidence, and the anti-inflationary effectiveness of the corporate tax.

* The author is employed as an economist with the Tax Advisory Staff of the Secretary, U. S. Treasury Department. The views expressed are his own and do not necessarily reflect those of the Department.

[1] Richard B. Goode, *The Corporation Income Tax* (New York: John Wiley & Sons; London: Chapman & Hall, Ltd., 1951).

[2] See Elmer D. Fagan, "A Fiscal Program for High-Level Mobilization," *National Tax Journal*, V (June, 1952), pp. 124-125.

The fiscal significance of the tax lends critical importance to the evaluation of its performance in the revenue structure. Second only to the individual income tax as a source of federal revenue, the corporation income tax alone accounted for roughly 30 per cent of net budgetary receipts of the federal government in the fiscal year 1952. Combined corporation income and excess profits taxes amounted to $21.5 billion or nearly 35 per cent of all federal revenue. Current estimates indicate that for the fiscal year 1953 direct taxes on corporations will amount to $24.8 billion, or about 36 per cent of total net budgetary receipts of $68.7 billion.[3]

Despite the fiscal importance of the corporate income tax, there continue to be basic differences among economists, businessmen, and other interested groups as to its economic effects and proper place, if any, in the fiscal system. Business attitudes are critical of both the level of rates and structure of the tax. Theorists tend to regard the unintegrated structure as an irrational element in the revenue system, comprising mixed elements of differential sales taxation, discriminatory treatment of a particular form of business income, and inadequate bringing to account of undistributed profits for tax purposes. In the doctrinaire system of such an outstanding authority as Simons, there is no place for a business income tax as such; income accrues only to individuals; only they have taxable capacity.[4] Yet the inescapable logic of events has compelled continuation and extension of the existing system of taxation of corporate business as such.

[3] Statement of the President reviewing the 1953 Budget, August 9, 1952.

[4] Henry C. Simons, *Federal Tax Reform* (Chicago: University of Chicago Press, 1950).

Tax Rates and Incentives

Since the defense emergency the level of corporate tax rates has taken precedence over the question of double taxation, *per se*. This involves the important question of what inherent limitations exist on the level of corporate tax rates in the light of business incentives, the problem of wasteful expenditures, equity effects on stockholders, and direct impact on available investment funds. A significant feature of discussions over the choice between the excess profits tax principle and a general increase in corporate rates after Korea was the apparent preference of many business groups for general corporate rates presumably as high as 55 or 60 per cent to a selective excess profits tax. This attitude doubtless indicated dislike of an excess profits tax more than acceptance of corporate income taxation as such. Nevertheless, it contrasted with earlier sharp opposition to the corporate tax even at much lower rates.

The figure of 50 per cent has sometimes been regarded as the critical level of corporate tax rates. At that rate the business and the government share as equal partners in net earnings. It is frequently contended that beyond this critical level incentives would be fatally impaired and wasteful expenditure practices would flourish. The special significance attached to the 50 per cent level has no tangible basis but reflects a somewhat nebulous psychological appraisal of investor and management reactions. Instinctive ideas of fairness are also said to be violated by rates above 50 per cent, a concept of tax limits which would presumably apply also to the individual income tax. The 50 per cent figure appears to be only loosely rated to the more objective factors of

economic requirements for dividends and business savings, and it is not ordinarily linked with the 25 per cent over-all effective rate of tax burden which the Colin Clark thesis holds will lead to inflationary degeneration.[5]

In the light of this general attitude, the increases in the corporate rate to 50¾ per cent for 1951 and to 52 per cent in 1952 might be regarded as having grave significance.[6] However, their importance was partly obscured by the higher combined income and excess profits rate and possibly by the provision for automatic reduction of the normal rate by 5 percentage points, effective April 1, 1954. It is too early to judge fully the results of corporate taxation at this level, and the experience under emergency conditions would in no event be necessarily applicable under more normal conditions. Nevertheless, no dire consequences have immediately emerged.

Corporate earnings after tax and investment expenditures have continued at or near record levels. Corporate profits before taxes were $42.9 billion in 1951, leaving about $18.7 billion after federal and state taxes. Of the latter total, about $9 billion was paid as dividends while about $9.6 billion was reinvested. Current profit levels (second and third quarters of 1952), estimated at $40 billion before and $17 billion after tax, appear slightly lower, although dividends at about $9.5 billion are higher. However, after inventory valuation adjustment for inventory profits of $1.3 billion in 1951 as against estimated inventory losses of $1.7 and $.7 billion, respectively, in the second and third quarters of 1952, recent rates of operating profits are comparable to last year, in spite of the recent steel strike and increasing accelerated amortization allowances.

At current rates, profits after taxes are running at nearly six times the $3 billion average level for the period 1936-1939 and about twice the average for the war period 1940 through 1945. Business expenditures for new plant and equipment amounted to $26.3 billion in 1951 and are estimated at around $27.5 for 1952, as against $5.5 billion in 1939.[7] Even after adjustment for price increases, these figures throw significant light on contentions that high corporate tax rates necessarily have a destructive effect on business enterprise.

Most over-all measures of business activity are at or near record levels. There is every evidence of a continued high or rising economic plateau. Moreover, the strategic factors most seriously considered as potential causes of a future downturn are components of the basic economic outlook not directly related to taxation—adjustments to the leveling off of defense expenditures, variations in consumer expenditures and saving, and the completion of the most urgent business programs for plant modernization and expansion.

[5] Cf., Joseph A. Pechman and Thomas Mayer, "Mr. Colin Clark on the Limits of Taxation," *The Review of Economics and Statistics*, XXXIV (August, 1952), p. 241.

[6] The present 52 per cent general rate for corporations compares with the 40 per cent top rate in effect during most of World War II and 38 per cent for the postwar period 1946-1949. The combined income and excess profits tax marginal rate of 82 per cent compares with the World War II peak of 85.5 per cent after the 10 per cent postwar credit.

[7] Current profits and business expenditure data from *Economic Indicators*, October, 1952, pp. 16 and 21-22. (Prepared for the Joint Committee on the Economic Report by the Council of Economic Advisers, Washington: U. S. Government Printing Office, 1952.)

There is increasing knowledge of the effects of taxation on particular types of business decisions, but the paucity of objective evidence as to the effect of the corporate tax on basic investment and management incentives makes this one of the most difficult aspects on which to reach significant conclusions. Much of present " knowledge " in this area consists of assumptions and argumentative viewpoints. This stems from the inherent difficulty of the subject as well as the fact that a large part of economic fact-finding and analysis in the tax area is developed or used primarily as an instrument of special pleading.

Reliable evidence on the motivation of corporate management suggests that a realistic theory of tax effects on incentives will be far more complex than that of the textbook and tax-hearing testimony. The important case studies of Butters and Lintner in the special area of young, growing business indicate the importance of nonmonetary incentives and the frequent unawareness of tax considerations by venturesome entrepreneurs in the formative stage of the business.[8] Comparative analyses of the internal economics of particular firms demonstrate important variations in response to an identical tax and market situation, due almost entirely to personal attitudes and predilections of dominant managers. Katona's findings indicate that corporate management behaves primarily and typically as a " salariat." According to this interpretation, management does not strive for a maximum profit but for a " satisfactory " profit, which is apparently one somewhat higher than the previous year's or not less than that of other firms.[9] Higher profit rates are generally eschewed, according to these findings, because of possible adverse effects upon public opinion, legislative action, customers, and labor.

How are changes in the dollar level of profits due to taxation incorporated into the " satisfactory progressive standard " of profits? What implications would this standard have with respect to pricing policy and the incidence of the corporate income tax, and how would varying forms of incidence of the corporate income tax affect its incentive impact? How do windfall elements arising from inflationary demand and defense expenditures cushion the incentive impact of high taxes? These are illustrative of the specific questions which press for answers in a balanced appraisal of the incentive question.

In the absence of more convincing knowledge of incentives, allegations of destructive effects of business taxes in a vigorous full-employment economy tend to be heavily discounted as expressions of natural resistance to paying taxes. Unfortunate as it would be to ride roughshod over incentives vital in determining and allocating supplies of scarce factors, including economic leadership, it would be intolerable to stalemate the task of meeting government expenses in a noninflationary way on grounds of doubtful incentive considerations, where it was possible to achieve sound fiscal goals and at the same time leave profits after tax near peacetime records.

[8] J. Keith Butters and John Linter, *Effects of Taxation on Growing Enterprises* (Boston: Harvard University, 1945).

[9] George Katona, *Psychological Analysis of Economic Behavior* (New York: McGraw-Hill, 1951), pp. 202-203.

Most objective appraisals accept the existing impasse with respect to the fundamental incentive aspects and are content to say a few sensible, if trite, things on the subject and let it go at that. However, there remain serious inconsistencies and ambiguities in the qualitative analysis. Much of the following discussion will necessarily tread familiar ground in the attempt to clarify and present new viewpoints.

The distinction is frequently overlooked between true incentive effects of taxes arising from their impact on net financial rewards and their effects on financial capacity or savings available for investment. While incentive response depends on having the financial wherewithal, the two are essentially different. Most claims of adverse incentive effects, particularly those voiced by small or growing businesses, actually are addressed to the latter consideration. Frequently, the most bitter complaints cite cases of dramatic business success, the problem being that taxes slow the rate of pyramiding of investment.[10] As such, these criticisms merit objective analysis, but it is apparent that keen concern over available retained earnings to take advantage of expansion opportunities implies that incentives in the true sense are substantially unimpaired.

Conflicting incentive implications of the marginal as opposed to the total income-compressing effects of taxation are generally recognized in the field of personal income taxation. But there is reason to believe that similar patterns prevail in the case of corporations, although the precise content of the motivation that may tighten corporate management efforts as income is squeezed and relax them as income increases above satisfactory levels may differ from that which governs individuals.

There are differences of opinion as to the relationship between the expected duration of high tax rates and their incentive consequences. One view is that temporary high rates of tax are less likely to react adversely on incentives, since the long-run outlook for financial return is less affected and the momentum of good management practices will carry through an interim of high taxes. On the other hand, high taxes which are anticipated to be temporary are said to raise special problems since they would tend to defer normal investment ventures and stimulate efforts to reallocate income to subsequent lower-tax periods.

Critics concerned with the adverse incentive effects of high corporate rates seldom hesitate in the face of uncertainty about the actual incidence of the tax or its relative impact on retained earnings and dividends, assuming it falls on profits. In some cases such concern is expressed by those who, on the one hand, conceive the tax to be shifted like a sales tax or cost-of-production item and, on the other, advocate heavier consumption taxes to relieve direct taxes on corporate profits. If indeed the corporate tax operated as an erratic differential sales tax, it might create special problems of business adjustment, but this would require a marked shift in prevalent claims that the tax directly stifles incentives.

The relativity of incentive effects of given tax rates to prevailing income levels, risk, real cost, and other factors

[10] See, for example, *Tax Problems of Small Business*, Hearings before the Subcommittee of the Select Committee on Small Business, United States Senate, 82d Cong., 2d sess., Part 1 (Washington: U. S. Government Printing Office, 1952).

is largely ignored in practical discussions. Incentivewise, the critical level of corporate rates depends on the circumstances. The dampening effect of a given tax load depends in part on how difficult it is to earn profits under existing conditions and on what effort and risk are involved. Incentive responses which may be tough at one time may be sensitive under other circumstances.

With the economy operating at forced draft and profit opportunities created by high civilian and defense demands, profits after taxes may still compare favorably with those under lower taxes but more adverse market conditions. Both the capacity and the willingness to invest may be fully protected in the aggregate by various offsets to high tax rates, particularly if tax adjustments are geared to conditions as they develop. Competitive motivation of business expansion is likely to be stronger with a rising market, in spite of high taxes, than in the converse situation with a static or declining market and low taxes. Under such conditions it is not realistic to appraise the adverse incentive effects of high taxes in terms of a stagnating economy. Fortunately for fiscal policy, under depressed conditions when enfeebled incentives might be more exposed to the adverse effects of taxation, the need for taxes in terms of contracyclical objectives would tend to be less.

The foregoing considerations are indeed so obvious that it may be argued that the current emergency experience with high corporate rates has been under such favorable conditions that it does not constitute a real test of their incentive impact even in the context of a full-employment peacetime economy. Fine questions as to what are minimum reasonable returns to induce ventures are less relevant in an economy where normally significant drags, frictions, and impediments to full employment are overcome by the impetus of large defense budgets. Moreover, a substantial part of fixed capital investment has been stimulated and diverted to essential defense purposes by means of accelerated amortization. Recent corporate tax increases have fallen to a great extent on inflationary profit increases which are in the nature of windfalls, impervious to tax deterrents. The economic and incentive effects of such taxes are not comparable with those of similar increases applied to a static level of profits which would decrease net income after taxes.

Macro-economic offsets to the apparent reduction of private incomes by taxation open up new incentive implications which are only gradually being understood. These include not only the income-creating effects of balancing expenditures against taxes on idle savings but also the mechanics of income generation by which the simultaneous imposition of taxes to meet public expenditures may, under certain conditions, increase total national income by an equal amount. Incentive aspects, like the incidence of the actual burden of the tax, need to be explored in this broader framework, even though this approach is not entirely congenial to common-sense attitudes.

The term "investment incentive" scarcely appears in Goode's exhaustive and objective analysis in this area.[11] He recognizes the complexity of the determinants of investment and observes that

[11] Goode, *op. cit.*, pp. 111-148.

the corporate tax may affect investment either via the anticipated return or the availability of funds. But the effect on the anticipated return may arise from immediate repercussions on general market demand (compared with those of alternative revenue sources) as well as from the direct impact on profits remaining after tax. Because of its relatively light impact on consumer demand as compared with major alternatives—the individual income tax and the excises—and its immediate burden on investor rewards or retained earnings, the corporate income tax epitomizes the clash between the consumer-purchasing power and investor-incentive approaches to the task of creating a favorable environment for enterprise. The macroeconomic view may help resolve this conflict by pointing to the consideration, gradually receiving more adequate attention, that a tax on purchasing power may reduce disposable profits and volume of production as much or more than a direct tax on corporate earnings.

The full implications of the incentive problem are not disclosed by case studies or the internal economics of the firm, due to the differing impact of taxes from the standpoint of the individual firm and its actual effect on the economy as a whole. From the social standpoint, a tax which falls on idle savings or inflationary excess is costless. To the extent taxes fall on excess business saving, they may not actually cut down aggregate profits; to the extent they curtail inflationary business spending, they may not decrease real investment. These facts may run counter to everyday notions, but they are vital to the understanding of the economic role of corporate taxation. In a society which relies on atomistic incentives, it is generally futile to exhort the individual to act voluntarily contrary to his own interests in furtherance of a social end. Nevertheless, if taxes are acceptable because they are the means of paying for necessary expenses, they should be more acceptable if they produce tangible returns in the form of a more prosperous and stable economy.

Freedom from taxation for a particular firm while enjoying the benefits of generally imposed taxes would give the exempt firm the best of two possible worlds. But, accepting the full implications of uniform taxation, the apparent burdens on the particular taxpayer may be subject to substantial compensation in the form of income creation or stabilization. In short, the choice between different taxes and resulting different economic environments (and profits) may normally favor substantial taxes on profits, in terms of the enduring prosperity of the taxpaying unit as well as the entire economy.

Wasteful Business Expenditures

Some recent views on the impact of high corporate tax rates have recognized the changed nature of the incentive problem and its relationship to economic stabilization under current conditions. The traditional objection to heavy progressive income or business taxes has been that they tend to destroy incentives essential to production, risk-taking, and investment and thus bring on depression, unemployment, and deflation. In view of its inapplicability under conditions of general inflationary pressures, this viewpoint has been revised. The danger is conceived that high tax rates would, instead of having

the desired deflationary effects inherent in taxation, become an engine of inflation. The practical conclusion would appear to be that unless incentives are effectively insulated from the tax burden, an increase in savings or a curtailment of the defense program are the only alternatives to serious inflation.[12]

Leaving aside the political and psychological refinements of the Colin Clark thesis, the economic interpretation of inflationary effects of high corporate rates appears to stem from two at least partly contradictory views of their impact on business expenditures and risk-taking. One is the idea that rising corporate taxation, unless accompanied by rising depreciation allowances and various tax-exemption incentive features, would reduce investment and output and thus contribute to inflation by its adverse effects on the supply side. This would appear to rest on special and not necessarily realistic assumptions as to the net effect on prices of a reduction of investment, output, and accompanying factor incomes. The other view relates to the alleged effect of high marginal rates of corporate taxation in stimulating so-called wasteful business expenditures. Both are at variance with another pessimistic view of the limitations of the taxing power which holds that the real dilemma of fiscal policy is that it cannot be utilized to the full extent needed for price stability without creating unemployment at a time when that might be more disadvantageous than price inflation.

Although essentially a peripheral aspect of the basic incentive problem, the effect of high rates on business expenditure practices merits careful attention. Under high tax rates the deduction of such expenditure shifts a substantial fraction of the cost to the government. Where some indirect or future benefit may be obtained, the net private cost is correspondingly low. Among the items considered peculiarly susceptible to tax-saving incentives are advertising budgets, executive compensation, research and development programs, and charitable contributions.[13]

The possibility of inflationary leakages and tax avoidance through so-called wasteful expenditures was frequently cited as a practical barrier to high marginal rates. On the other hand, once the emergency rates were adopted, various counsellors urged businessmen to re-examine their policies to uncover every available opportunity to acquire capital assets or divert profits under the guise of deductible expense, a high proportion of which would be borne by the government.

Many of the specific outlets urged constitute risk ventures. It is implied that by taking thought and observing prescribed rituals, the Treasury could be converted into a "benevolent partner." Some businesses have specifically rejected these suggestions as counsels of profligacy. They point out that the larger over-all load increases the importance of each remaining income dollar and necessitates greater vigilance against waste or ill-calculated risk. There is little basis for a less conservative position since a given rate of tax reduces the taxpayer's share of outlay

[12] See John H. Williams, "An Economist's Confessions," *American Economic Review*, XLII (March, 1952), pp. 18-19.

[13] With reference to the charitable contribution item, see Beardsley Ruml and Theodore Geiger, *The Five Percent*, National Planning Association Pamphlet, 1951, and *The Manual of Corporate Giving*, edited by Beardsley Ruml and Theodore Geiger (Washington: National Planning Association, 1952).

and return proportionately, leaving the ratio of return to expenditure, both computed ex-tax, unchanged.

In this connection, the Commissioner of Internal Revenue has made it clear that excessive and unreasonable business expenditures claimed as tax deductions would be scrutinized carefully to prevent tax avoidance and abuse.[14] Private tax practitioners have also urged a cautious attitude on the part of business toward the temptation to make uneconomic or wasteful outlays on the assumption that the cost would be met by "cheap tax dollars." [15]

The net impact of corporate income and excess profits tax rates on business expenditure practices will doubtless vary in particular cases. A questionnaire survey of about 1,500 business firms undertaken in 1950 by the Research Institute of America disclosed that only about one-sixth of those surveyed felt that a 50 per cent rate would make management more inclined to undertake expenditures on the basis of tax consequences rather than business policy. It also indicated that business generally held the view that the inflationary effect of taxes on business expenditures would not become marked at rates up to 70 per cent, approximately equal to the present top effective rate of combined income and excess profits tax liabilities.[16]

Some observers have presented high tax rates in the guise of a potential subsidy encouraging better service, better coverage, better inventory stocks, increased advertising and promotion, research and experimental work, and similar semicapital outlays which could be expensed or amortized rapidly.[17]

One of the paradoxes of the "benevolent-partner" approach is that it is sometimes asserted by those who feel sure that corporate taxes are merely another business cost shifted to consumers or suppliers. Anyone must be incredulous, however, toward the prospect of the same tax dollar being simultaneously charged to consumers and spent for corporate development purposes at government expense.

Unless they constitute mere disguised remuneration or distribution of earnings in the form of various perquisites for executives or stockholders, unusual expenditures to be advantageous to the taxpayer must in fact be some form of investment. There would be no intelligent purpose in wasteful expenditures for their own sake without hope of acquiring additional deferred or partially exempt income, reallocating income to future lower-tax years, or building up an ultimately valuable asset.[18] Critical

[14] Statement of the Commissioner of Internal Revenue, Bureau of Internal Revenue Press Release, dated February 26, 1952.

[15] See, for example, Merle H. Miller, "How Cheap is the 18-Cent Dollar?", *Fortune* (November, 1951).

[16] Statement of Leo Cherne, Executive Secretary, Research Institute of America, Inc., *Excess Profits Tax on Corporations*, 1950, Hearings before the Committee on Finance, U. S. Senate, 81st Cong., 2d sess., pp. 121-124.

[17] Statement of Beardsley Ruml, Business Committee on Emergency Corporate Taxation, *Excess Profits Tax on Corporations*, 1950, Hearings before the Committee on Finance, U. S. Senate, 81st Cong., 2d sess., pp. 109-121.

[18] This presupposes a special inducement to such expenditures if the high rates are regarded as temporary. The viewpoint expressed here contrasts, however, with Goode's conclusion that "Prudently managed firms will try to prevent lax and inefficient practices from becoming imbedded in their cost structures in order to maintain their long-run competitive position, even when the short-run effect on profits after tax is minor. . . . Of course, if high marginal tax rates come to be regarded as more or less permanent, customary safeguards against inflated costs may slowly weaken." Richard Goode, "Anti-Inflationary Implications of Alternative Forms of Taxation," *American Economic Review*, Papers and Proceedings, XLII (May, 1952), pp. 147-160.

scrutiny indicates that the temptation to make such expenditures has been grossly overemphasized. Their attractiveness from the tax standpoint would presuppose the ability to masquerade capital outlay as current expense, a form of tax evasion which is normally quite limited.

Corporate Tax Unneutralities and the Neutrality Doctrine

The doctrine of tax neutrality, particularly in its application to the corporate area, has enjoyed a considerable vogue. Although of general theoretical application, it has been concerned primarily with what are termed unneutralities imbedded in the present corporate tax structure.[19] These include such now familiar aspects as differential treatment of distributed and undistributed earnings, corporations and partnerships, dividends and other investment income, corporations which are and are not in a position to distribute a major part of earnings as salaries, and the alleged discrimination in favor of debt as against equity financing.

As originally formulated, the neutrality criterion required that a tax should not alter the allocation of economic resources or distort business arrangements.[20] The heroic requirements of such a standard as applied to a revenue instrument of the magnitude of the corporate tax are apparent. A less exacting concept of neutrality has been defined as impartiality or the particular aspect of tax equity consisting of equal treatment of similarly situated taxpayers.[21] Deviations from neutrality are sanctioned, however, provided they are deliberate and for an adequate public purpose.

One would indeed be insensitive to crudities or inequities in taxation to deny substance to many of the particular points developed by the neutrality school. Nevertheless, the general principle of tax neutrality seems a will-o'-the-wisp. It is inconceivable that revenue goals associated with modern budgets could perform the essential functions of diverting needed resources to government use without altering the relative proportions and allocation of those remaining for private use. This is true of any particular tax of the magnitude of the corporate tax or, indeed, of any revenue source which is a part of modern tax structures. In a sense, therefore, the pure idea of tax neutrality may seem hostile to the fundamental purpose of taxation: to provide the financial counterpart of a reallocation of resources as between private and public use in accordance with the determined needs of the community. However, the actual position of the neutrality school would seem to be that, after financing the preemption of resources needed for public use, the tax system should not affect the private allocation of the remainder (other than the normal readjustment to the new proportions),

[19] See *Preliminary Report of the Committee on the Federal Corporate Net Income Tax*, National Tax Association, *Proceedings* of the Forty-second National Conference, 1949, pp. 437-470; *Final Report of the Committee on the Federal Corporate Net Income Tax*, National Tax Association, *Proceedings* of the Forty-third National Conference, 1950, p. 54; and Harold M. Groves, "Revision of the Corporation Income Tax," National Tax Association, *Proceedings* of the Fortieth National Conference, 1947, p. 99.

[20] See *Report of Committee of the National Tax Association on the Taxation of Transportation*, Carl S. Shoup, Chairman, National Tax Association, *Proceedings* of the Thirty-ninth National Conference, 1946, pp. 71-103.

[21] See Harold M. Groves, "Neutrality in Taxation," *National Tax Journal*, I (March, 1948), pp. 18-24.

through discriminations as between alternative forms of business organization, varying degrees of capital intensity, large versus small scale, different directions of consumer choice, and the like.

Neutrality proponents admit the desirability of intended discrimination or unneutrality in favor of action or inaction considered in the public interest. They might conceivably welcome, for example, accelerated depreciation, expensing of various types of capital outlays, or special favorable treatment of small business. But even traditional tax theory might favor the encouragement of desirable economic effects and the avoidance of undesirable ones wherever consistent with equity or other major objectives. In practice, therefore, the neutrality objective may boil down to an appraisal of the economic effects of taxation with a view to structural adjustments to avoid undesirable repercussions. In these general terms, it merely elaborates and stresses widely accepted principles. Pushed further, it embodies a form of doctrinaire abnegation with respect to the inevitable regulatory effects of taxation or the self-deceptive belief that the tax system should be designed to operate as though it was not there. None of the productive factors or their distributive shares could be neutral in the latter sense. In view of the inevitability of the economic effects of large tax requirements, many of which can be justified only by the important public purpose of revenue adequacy, a futile attempt at neutrality would enmesh the tax-making process in endless difficulties.

Since all feasible alternative sources of revenue have unneutralities which would be aggravated by disproportionate use, one would expect the neutrality school to recognize diversity as an important practical means of greater neutrality. Unneutrality is indeed such an inherent feature of the selective excises that they are defended by a neutrality proponent only "in the name of legitimate social purpose—namely, adequate revenue at minimum cost of collection and public reaction." [22] This would appear to be a sufficiently flexible criterion to justify substantial business income taxation. The other major alternative —individual income tax—has been termed a subsidy on leisure and liquidity. The treatment of various kinds of imputed income and deduction items under the individual income tax are also important technical sources of difficulty in applying the strict neutrality canon. These points illustrate some of the weaknesses of singling out the corporate income tax on neutrality grounds.

Although the skepticism expressed here with respect to the desirability or feasibility of the neutrality standard is probably widely shared, many of the particular criticisms directed at the so-called unneutrality of the corporate income tax have been widely accepted. One of these is the alleged premium on bond financing, due to double taxation of dividends.

Extensive empirical studies have disclosed no measurable effects on corporate financial policy of the alleged bias in favor of debt financing. In spite of higher tax rates, there has been no discernible trend toward debt as against equity financing. [23] This has frequently been ascribed to the aversion to

[22] Groves, *op. cit.*, p. 21.

[23] See, for example, Goode, *op. cit.*, p. 137, and George E. Lent, "Bond Interest Deduction and the Federal Corporation Income Tax," *National Tax Journal*, II (June, 1949), p. 141. Although Lent believes there

(footnote concluded on following page)

debt, although it would seem that this would be counterbalanced by reluctance to dilute equity by external financing. The predominance of internal financing, particularly in recent years of high rates of retention, has left relatively narrow scope for choice between debt and outside equity methods.

The deductibility of various cost or service items necessarily leads to a different over-all tax result depending on whether furnished by the owner of the business or outside suppliers under any net income tax. Whether this difference would distort financial decisions depends primarily on the degree of community of interest between owners or shareholders and lenders or suppliers. Where such community of interest exists, special arrangements of the capital structure may be sought as a tax avoidance device, without having general economic significance.

The alleged tendency toward debt financing in the case of publicly held corporations is frequently misconceived as a specific tax inducement to owners or managers. The implied interest of corporate managers in sparing outside bond investors a corporate tax on their investment earnings is, of course, a fiction. The motivation towards bond financing seems more real if described as the desire for "cheaper financing" or tax savings for the business by diverting profits needed to raise capital in the form of deductible interest. But similar motives could be attributed to proprietors or partners under the individual income tax and are not peculiar to overlapping taxation of dividends.

A more accurate view of the alleged bias toward debt sees it in terms of the attitude of outside investors, reflected in a preference for debt securities which constitute a kind of prior lien on income before taxes. Other things being equal, this would enhance the salability of bonds as compared with stocks, although there would be compensating advantages, tax and otherwise, for corporate equities. In any event, this would be only one of many factors affecting security markets.[24] But this analysis treats the problem in too narrow terms. It overlooks the tendency of the corporate tax to lower the general yield of both stocks and bonds. There is no reason to believe that under the lower general yield structure, even with a reduced differential between stock and bond yields, demand for bonds will necessarily be greater. The absolute reduction of bond yields may actually enhance the relative demand for stocks.

Any tendency toward increased use of debt tends to be self-correcting. For if corporate managers choose the debt method they are, paradoxically, increasing the "leverage" of the stockholders' equity and thus its profit potentiality,

---

is evidence of declining importance of preferred stock as against common stock, due to tax pressures, this would not seem to be directly due to double taxation of dividends since it would merely reflect reluctance on the part of equity owners to assume tax liability for a preferred equity group. See also, Dan Throop Smith, *Effects of Taxation on Corporate Financial Policy*, Graduate School of Business Administration (Boston: Harvard University, 1952).

[24] Indeed, the alleged dearth of equity capital as compared with loan funds has been attributed to a variety of factors other than double taxation of dividends, such as individual surtaxes on high-income groups alleged to provide the bulk of risk capital, institutionalization of savings, margin requirements, liquidation of stocks by estates, and a supposed shift in income distribution toward groups not inclined to invest in stocks. See Stanley L. Miller, "The Equity Capital Problem," *Harvard Business Review*, XXVI, No. 6 (November, 1948), pp. 671-679.

subject to the unintegrated tax which the debt financing was presumed to avoid. This would tend to restore the balance.

These considerations may help explain the failure of empirical studies to disclose a trend toward corporate debt financing.

Double Taxation of Dividends

Among the various corporate tax unneutralities, the major target of criticism has been treatment of dividends under the present method of coordination of the individual and corporate taxes. The unintegrated corporate tax structure has been charged unstintingly by its critics as being an inequitable component of the revenue system and prejudicial to investment incentives. The criticism on the grounds of equity has been advanced both by those who believe the corporate income tax to be shifted like a sales tax to consumers and by those who treat it primarily as a tax on stockholders. The former charged undue regressiveness; the latter, undue and distorted progression. The distortion is variously traced to three factors: (1) the cushioning effect of the implicit deduction or exclusion of corporate tax from individual income, which results in a lesser impact from double taxation the higher the income of the stockholder, (2) the premium which the present system frequently places on retention of corporate earnings subject to a single flat-rate tax, and (3) the taxation at source of low-income stockholders.

Various offsetting considerations have been pointed out from time to time in clarifying the double taxation issue: (1) double taxation occurs only in the economic sense since the corporation and the shareholder are separate legal persons, (2) even from the economic standpoint it hinges on the uncertainties of incidence; moreover, the shareholder may be unaware of the corporate tax, while corporate management may ignore the individual's tax on his dividends, (3) the extent of double taxation is less than commonly thought since a substantial portion of dividends is received by tax-exempt organizations and persons below the exemption level; moreover, the equity problem may be greatest in the latter situation where there is no double taxation as such, (4) the uncoordinated structure does not result in differentially higher taxation of business income in the case of many small and medium-size businesses with high rates of retention and shareholders in high personal income brackets, and (5) only individuals owning stock at the time the corporate tax was imposed or increased are really affected by double taxation; subsequent investors acquire stock at prices presumably giving a satisfactory expected yield in comparison with alternative investment opportunities. As some of the above points suggest, the alleged inequities encompassed by the double taxation slogan were more accurately attributable to the combined effects of (a) taxation of corporate earnings at source under a relatively high proportional rate, and (b) exemption of retained earnings from individual income tax except for their possible inclusion in realized capital gains. The limited range of double taxation of dividends is only an aspect of the wider problem.

Specific proposals generally were designed to integrate with varying accuracy the corporate and individual taxes with respect to dividends, while

retaining the flat corporate rate on undistributed profits. Those which provided dividend exemptions at the individual level also disregarded the equity problem of the low-income investor. Full integration through the partnership approach—the only method of completely eliminating the tax effects of the corporate form—received scant attention, except for small companies.

All these proposals recognized in varying degree the problems of (1) how to replace the resulting revenue loss, (2) how to deal with possible windfalls to current holders of corporate equities due to capitalization of the tax, and (3) how to bring retained corporate earnings fully to account for tax purposes. But they rested logically on two related assumptions: (1) that the tax is borne by stockholders and (2) that it is essentially a supplement to the individual income tax. In general, they shirked coming to grips with the complex questions of incidence and imputation of tax on retained profits and how to provide adequate recognition under the tax system of the economic importance of corporations as prime income recipients in a high-level economy.

While not always firm or consistent on the question of shifting,[25] most critics of the present structure give short shrift to the idea of business taxation as such and consider only some form of tax on undistributed profits as a rational part of the system. In the past, intellectual support for business taxation has comprised the traditional justifications based on the separate ability, benefits, or privileges of the corporate entity, alleged need for control of persistent monopoly elements in corporate profits, and the difficulties of otherwise integrating the corporate and individual income levies.[26] The more practical considerations which have governed continued reliance on the present system of corporate taxation are its revenue productivity, contribution to diversification, administrative convenience, and the traditional presumption in favor of an established tax.

A new approach, exemplified by Goode,[27] emphasizes the effect of the corporate tax on national income and employment, and it applies the basic test of consistency with the ultimate goals of fiscal policy. On this comprehensive basis Goode assigns a relatively low priority to the adoption of methods of general integration of corporate and individual income taxes to eliminate the so-called double taxation of distributed profits, with the possible exception of the partnership option for small firms.[28] This constitutes a sharp break with the consensus prevailing during the postwar period.

Goode's approach stresses the ability of the corporate income tax to encourage full production by absorbing redundant corporate savings, the related compatibility of the corporate tax with

[25] The minority of integration proponents who held the tax was shifted as a sales tax neglected to consider whether the amount supposedly shifted was the entire tax or merely the net differential, if any, due to double taxation (after allowance for the possible advantage of the flat corporate tax on retained earnings). The amount of such differential is variable and practically indeterminable in the case of most large corporations. Shifting of the entire tax, on the other hand, would not only relieve double taxation of dividends but would result in complete tax exemption of retained earnings.

[26] See Harold M. Groves, *Postwar Taxation and Economic Progress*, Committee for Economic Development Research Study (New York: McGraw-Hill, 1946), pp. 20-27.

[27] Goode, *op. cit.*

[28] *Ibid.*, p. 217.

an over-all burden distribution designed to encourage consumption, and the encouragement to investment through the certain stimulus of broad consumer markets as against narrower conceptions of a tax environment favorable to investment. In addition, considerable attention is given to the corporate tax instrument as a contracyclical stabilizer since the volatility of the corporate profits base as compared with income or consumption affords unusual built-in flexibility.[29]

If the broader approach just outlined has neglected anything, it has been the implications of an economy in which profits are in large part dependent on and sustained by broad national policies designed to maintain stable high levels of employment and output. A salient lesson of modern monetary and general equilibrium theory is that, whatever their particular functions in rewarding investment risk and efficiency and in allocating the factors of production, profits in the aggregate are governed by the balance between private investment and government expenditures on the one hand and savings and taxes on the other. Thus, the level of net profits for the economy as a whole is, in a special sense, determined by over-all credit and fiscal policy. A tendency toward an excess of saving plus taxes over investment plus government expenditures gives rise to "windfall losses," the effect of which is to reduce aggregate net profits by a corresponding amount. On the other hand, an excess of investment plus government expenditures over combined taxes and savings produces "windfall gains," or a corresponding increment in profits.

[29] *Ibid.*, pp. 25-43, and 203-217.

Corporate incomes, which in a sense are the creature of monetary and fiscal policy, in turn occupy a strategic position in the sequence of price, profits, and income-cost inflation (or deflation). Business responses to profit changes are important in determining the cumulative reactions and income-cost adjustments which ensue. Business will have the "alternatives" of varying production or prices. Profit changes may be incorporated into costs and incomes by bidding up factor prices (meeting wage and supplier demands). Business may absorb persisting profit changes by adjustments of dividends or retained earnings. It may "finance" losses by borrowing, drawing down cash holdings, or selling assets.

These considerations underscore several potential advantages of profits taxation:

1. It may help give the economy greater resilience and resistance to shock. Profits after taxes will vary less than total profits. To the extent undesirable profit changes are absorbed by the revenues while government expenditures remain the same, an unsought inflationary or deflationary sequence may be terminated at the point where it is most clearly reflected and before it spreads to costs and other incomes.

2. Taxation of corporate profits as such may buttress fiscal, monetary, and credit policies by helping to mop up or recapture windfall profit increases due to net disparities between savings and investment, government receipts and expenditures. The penalties of error, particularly overshooting the mark, are less serious with a backstop in the form of the corporate income tax.

3. Since it cushions variations in profits after tax, the corporate income

tax may help combat the one-way rigidity of prices (stickiness downward, flexibility upward). Thus, it may help direct expansion trends into volume increases and convert contractionist tendencies into mere price changes.

Shifting and Incidence

The answer to the question of who actually sustains the burden of the tax would throw significant light on all the other related issues of equity and economic effect, including double taxation of dividends, impact on investment incentives, and supply of equity funds. Progress has been made toward more comprehensive and realistic concepts of shifting and incidence. But at each step of the advance new vistas have opened up, increasing the complexity of the problem. Present incidence theory, with respect to both the corporate tax and taxation generally, is in a state of transitional confusion.

The consensus appears to remain, however, that the major incidence, as ordinarily understood, is on corporate profits. Whether that is equivalent to incidence on stockholders raises important secondary questions relating to the extent of absorption of the tax from retained earnings rather than dividends and the imputation of retained earnings to stockholders' income. Some regard imputation as valid, consistent with the idea that the corporation has no independent taxpaying capacity apart from its shareholders, while others consider it a fictitious procedure.[30] Actually, the validity of imputing retained earnings as income to shareholders would vary widely from the closed corporation in which they are indistinguishable from the owners' personal savings to special situations in which they may be held akin to operating costs.

The problem is also partly one of definition, since the answer to the incidence question will vary depending on whether the scope of analysis stops with the short-run price and output decisions of the firm, extends to the long-run adjustment of capital investment, or is elaborated to include broad economic effects on aggregate employment and level of income. The latter requires basic recasting of traditional incidence concepts originally designed to apply to such limited problems as tracing the burden of a particular commodity excise to its ultimate bearers. The broader approach prevents a single clear-cut conclusion since the economic adjustments affecting incidence would vary with the type of business, market and competitive conditions, and the general economic outlook. It also blurs the logical concept of incidence since it introduces a possible divergence between the social and the apparent private burden of a tax.

The field of corporate tax incidence is currently occupied by three recognized views: the traditional theory, its modern criticism, and the aggregate-demand approach advanced by Goode. The traditional theory holds that the corporate income tax cannot be shifted either by a competitive business or a monopoly. This theory rests on the assumption of profit-maximizing behavior and the concept of price and output determination based on the equalization of marginal cost and a marginal revenue. At

[30] Cf., *Distribution of the Tax Burden*, Memorandum submitted to the Canadian Senate Standing Committee on Finance, June 12, 1952, by the Canadian Tax Foundation. *Tax Bulletin*, Canadian Tax Foundation, II (July-August, 1952), pp. 198-199.

this point of equalization there is no increment of profits or profits tax. Consequently, the tax, whether or not treated as a cost, will have no effect on the short-run price or output decisions of a rational producer. For the long run, the traditional theory by and large rejects the idea of shifting on the grounds that a universal tax applicable to the dominant form of enterprise would not affect the general supply of capital, although it might have some relative price effects as between areas of enterprise depending on the importance of the corporate form.

Modern criticism has given greater emphasis to possibilities of short-run shifting which the traditional theory only incidentally recognized and has advanced new ones based on the nuances of imperfect or monopolistic competition and institutional business behavior.[31] If accepted, this type of criticism tends to restore what was once considered a crude view—that the corporate tax is immediately added to price like a specific excise.

Basically, these criticisms question the underlying assumption of profit-maximizing adjustments of price and output by the firm. One aspect relates to so-called "administered-price areas" in which potential monopoly power is not fully exploited and prices might be nudged higher by corporate tax increases. An instance of this is so-called "stay-out" pricing, designed to discourage competitive entry. Attention is also given to average-cost-plus-mark-up or similar formula pricing, which would include income tax in the pricing base. Doubt is expressed that firms want to maximize profits or that if they did they would know how to do so on the basis of their cost and market information systems. Consequently, the theoretical profit-maximizing behavior is supplanted by various rules-of-thumb which may or may not actually approximate maximum profits in some time period or other.[32] Routinized response to anything, including taxation, which impinges on profit is also alleged to induce shifting in the sense of higher prices. Still a different view is that a fair market return on equity working capital is frequently an important variable cost which would be affected by taxation even in the short run.

While these considerations tend to establish possible mechanisms for shifting, their proponents also recognize a number of difficulties and reservations. Since the tax will vary as a per cent of sales from one firm to another,[33] precise shifting would necessitate price differences or product differentiation. Since additional profits are themselves taxable, the higher the tax the greater the incentive but the more difficult it is to pass the tax on; moreover, a price adjustment which adds the tax to the consumer's bill will not necessarily maintain profits after tax, while one which shifts the tax in the sense of maintaining profits after tax would involve a multiple burden on the consumer. The possibility of shifting apparently open to the individual firm or industry may

[31] For a discussion of a number of these matters, see Carl S. Shoup, "Some Considerations on the Incidence of the Corporation Income Tax," *The Journal of Finance*, VI (June, 1951), pp. 187-196.

[32] K. E. Boulding, "Implications for General Economics of More Realistic Theories of the Firm," *American Economic Review*, Papers and Proceedings, XLII (May, 1952), pp. 35-36.

[33] See Carl S. Shoup, "Incidence of the Corporation Income Tax: Capital Structure and Turnover Rates," *National Tax Journal*, I (March, 1948), pp. 12-17.

prove to be an illusion because of differences between its limited viewpoint and the over-all economic realities where a general tax applies.

In addition to these difficulties, the limits of the zone in which these shifting mechanisms operate are highly uncertain. In particular, one may wonder whether so-called " administered " prices are not as frequently above as below the point of maximum profits. Consequently, the modern criticism probably represents more of a theoretical than a practical triumph over the traditional doctrine.

Goode's contribution relates to the role of aggregate demand in effectuating or blocking forward shifting of the corporate tax, with particular reference to the effects of a long-run restriction of investment. He asserts that for the investment mechanism to induce shifting, it would be necessary to restrict output and raise prices. However, a decrease in investment would be incapable of raising prices unless it also increased aggregate effective demand, whereas the contrary result of lower employment and price deflation is more likely.

Orthodox equilibrium theory might argue that the essence of shifting is a change in relative commodity and factor prices which might be effected at any given level of aggregate demand. Since the Keynesian model used by Goode is not a short-run system, it does not seem correct to say (with Groves) [34] that Goode falls back on short-run analysis to explain long-run incidence. However, his argument accepts the condition of a long-run decrease in investment which is not necessarily consistent with his own evaluation of the broad results of the corporate tax. The significance of his conclusion is also blunted by the fact that it is not peculiar to the corporate tax and would apply with almost equal force to any general tax, including a consumer sales tax, where shifting required a general increase in the price level. In fact, as Goode recognizes, this approach applied to sales tax incidence would suggest that it was on profits or other factor rewards, a reversal of accepted doctrine which has recently been reasserted with full recognition that, if true, tax theory is in its infancy.[35] In addition to losing sight of the crucial element of relative prices and factor incomes, concepts of an aggregate-demand barrier to forward shifting appear to rest on misconceptions of the mechanics of income generation and transfers in connection with tax adjustments.[36]

[34] *The Review of Economics and Statistics*, February, 1952, p. 90.

[35] Earl R. Rolph, " A Proposed Revision of Excise Tax Theory," *Journal of Political Economy*, LX (April, 1952), pp. 102-117.

[36] Leaving aside questions of monetary and credit arrangements affecting the level of money demand, availability of unemployed resources, and timing, the mechanics of transition to the new price level would vary depending on whether the tax increase financed additional government expenditures, supplanted another tax, increased a surplus, or reduced a deficit. If a sales tax, for example, was substituted for a direct tax on individual incomes, private money demand would tend to be released to sustain the higher prices. It is not necessary to assume that the old tax curtailed private demand more than the new one since price increases which are part of the mechanics of tax incidence and collection impose no greater draft on aggregate demand than an equal direct tax. If the tax financed additional public expenditures, aggregate demand would tend to be correspondingly increased. If the tax reduced a deficit and halted price inflation, it would shift the burden from recipients of fixed or sluggish incomes whose effective demand would thus be greater than otherwise. Even if the tax created a surplus which tended to deflate prices and incomes, the price decrease would be relatively less than under a direct income tax of the same magnitude because of the adjustment involved in tax shifting, assuming the other requisite conditions for shifting to be present.

None of these comments imply, of course, that the corporate income tax is shifted. They indicate, however, that aggregate demand does not constitute a mechanical obstacle to shifting in the sense sometimes suggested.

In view of prevailing uncertainties, tax burden studies necessarily adopt arbitrary assumptions in regard to corporate tax incidence and its allocation as between retained earnings and dividends in order to achieve results.[37] While such studies perform a valuable function in exploring the implications of alternative assumptions, they involve the danger that the essentially schematic results should gain currency as conclusive findings. Rules-of-thumb indicating some fraction of the tax to be shifted represent weighted averages of widely differing conditions assumed for particular firms or industries. They do not represent a single economic law of shifting.

Anti-Inflationary Effectiveness of the Corporate Tax

Under the older theory of taxation, a dollar of revenue from one source was equally as good in terms of basic revenue objectives as one from another. Modern fiscal theory has come to differentiate, however, between alternative revenue sources with respect to their anti-inflationary effectiveness. Generally speaking, taxes which fall largely on consumer purchasing power, otherwise devoted to spending rather than saving, are considered anti-inflationary. Those which fall on saving are not.

In recent years the corporate income tax has thus tended to receive a comparatively low rating on the anti-inflationary scale.[38] This reflects chiefly the tendency to regard the inflation problem in the first instance as the consumer gap. The impact of the corporate tax on consumer spending via dividends is deemed less dollar-for-dollar than other alternatives. At the same time, its impact on corporate savings is frequently considered either as superfluous, particularly if there are direct controls on capital expenditure, or worse than futile if tax pressures on corporate funds increase resort to credit.

In this framework the corporate income tax has been regarded as an anti-inflationary weapon chiefly in its indirect role of absorbing profits which might otherwise be the target of wage demands. Thus, its major anti-inflationary function has been deemed its damping effect on the cost-price "push," although corporation tax revenue is considered superior from both the long- and short-run stabilization standpoint to an equivalent deficit. The corporate income tax is also sometimes assigned the strategic secondary role of balancing and increasing the acceptability of taxes on individuals.

[37] The recent study by Musgrave and associates, for example, made three alternative assumptions in regard to incidence (entire incidence on profits, full forward shifting, and one-third forward and one-eighth backward shifting—the latter being termed the standard case) plus two different methods of imputing the tax on retained earnings, making six distinct alternatives. R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, "Distribution of Tax Payments by Income Groups: A Case Study for 1948," *National Tax Journal*, IV (March, 1951), pp. 1-51.

[38] While Goode has expressed the opinion that the anti-inflationary effect of the corporate income tax is somewhat weaker than individual income and commodity taxes, he differs from the standard position in contending that the differences among major taxes in this respect are small and have been exaggerated. Richard Goode, "Anti-inflationary Implications of Alternative Forms of Taxation," *American Economic Review*, Papers and Proceedings, XLII (May, 1952), pp. 152-154 and 160. For a dissent, see comments of Harold M. Somers, *Ibid.*, pp. 165-166.

This general view tends to understate the anti-inflationary effect of the corporate tax in a situation in which heavy capital expenditures, financed to a considerable extent from retained corporate earnings, outstrip the capacity of the economy for physical expansion. Modern fiscal theory has fallen into error through its basic assumption that investment is divorced from savings. This has never been entirely true with respect to corporate savings and capital expenditures since even in periods of stagnation a considerable volume of corporate investment is contingent upon retained earnings, while a substantial volume of retained earnings is a factor predisposing the corporation toward more liberal capital development outlays. The assumption is even less realistic during periods of booming capital outlays when credit facilities are under strain and each additional dollar of retained earnings is likely to be devoted to capital expenditure.

In the short run, at least, capital expenditures are as inflationary as consumption since they either divert productive factors from consumption or add to the excess demand for factors already devoted to capital expansion. In the longer run, real capital investment serves to increase the output of consumer goods. However, excessive capital expenditures may actually fail to increase available supplies if excessive dollar outlays run to inflationary waste. Capital development expenditures are especially prone to inflation since they are not subject to immediate competitive cost considerations.

The previous discussion of the problem of wasteful business expenditures indicated that major importance should not be ascribed to this factor as a source of inflation. Any significant rate of income tax has some effect on expenditure calculations at the margin, particularly if the differentiation between outlays of a capital nature and expense is imperfect. Much of the supposed increase in such expenditures under present tax rates is probably an increased awareness of this condition. To the extent greater impetus toward tax-motivated expenditures should develop, it may be met by reasonable adjustments of administrative procedures.

The corporation income tax may, within proper limits, perform at least as well anti-inflationwise as other revenue sources. In some varieties of inflation, where corporate profits are feeding excessive capital expenditures subject to limited direct controls, the corporate income tax may be the most effective fiscal instrument.[39]

Conclusion

The urgent necessity for corporate tax reduction or reform as a stimulus to private investment has been the central theme of discussions of the problem of making business enterprise work successfully. Probably this is an undue emphasis. It may be questioned whether the supporting data have fully sustained the criticism of the present structure. Certainly it is difficult to

[39] This analysis is entirely consistent with the view that the corporation income tax may, in certain situations, contribute toward higher levels of employment and income while absorbing redundant savings. Corporate savings may tend toward idleness in depression and be an active motivating force toward additional expenditures during boom periods. The combined effect of the cyclical volatility of the profits base and the varying relationship between corporate savings and capital expenditures may give the built-in flexibility of the corporate income tax a double-barreled effect.

reconcile contentions that the tax system has gravely penalized growth and progress with the expansion of the economy since World War II.

To a considerable degree the alleged constraint of corporate taxes on growth and expansion may be an illusion fostered by the differing viewpoints of the firm and the economic system. Particularly at high profit levels, each individual firm contemplates the expansion which it could undertake if its tax load were substantially reduced. But if all firms were relieved of taxes to the same degree, the situation would be different for obvious competitive and over-all equilibrium reasons.

Taxation should be guided by the best available understanding of its economic effects, but perfect technical knowledge would still not eliminate all conflict and uncertainty. The formulation of the business tax structure will never be as simple a matter as finding one's way along a well-marked highway. Considerations of group interest and related value judgments will necessarily modify technical and economic considerations.

While the present structure embodies elements of both personal and business income taxation, the resulting conflicts are not intolerable so long as there is substance in the view that corporations are not devoid of separate economic entity. Corporation income taxation has played an especially important role during the postwar period. In some circumstances, it may be virtually an indispensable method of gearing revenues to the full capacity of the economic system.

THE FINANCIAL STRUCTURE OF THE GOVERNMENT OF LONDON *

INSTITUTE OF MUNICIPAL TREASURERS AND ACCOUNTANTS

Chapter I

INTRODUCTION—THE AREA AND THE AUTHORITIES

THE AREA

"LONDON" is an ill defined term, and, taken in different contexts, may mean many different things. It may mean the small area known as the City of London, the historic city of the Romans, still maintaining its mediaeval system of government and clinging tenaciously to its hard won rights within its square mile; it may mean the administrative County of London, founded in 1888, with an area of 117 square miles based on the boundaries rather haphazardly drawn for its predecessor, the Metropolitan Board of Works, in 1855; or it may mean the economic and physical fact, a vast built-up area of many hundreds of square miles and including such dormitory towns as Brighton sixty miles to the south and Letchworth forty miles to the north. There is no one administrative authority responsible for this last conception, the limits of which would in any case be almost impossible to define, and the area which is most conveniently taken as the subject of this study is that known as Greater London, which coincides substantially with the Metropolitan Police District and the City of London. This comprises an area of about 700 square miles, and at the 1951 census it contained 8,346,137 persons, or about one-fifth of the total population of England and Wales. For many services, such as sewerage and water supply, police and transport, this area forms a convenient physical unit, and to a certain extent this fact is reflected in the administrative arrangements.

A historical inquiry into the growth of this Greater London area would be outside the scope of this study, but the following table, based on the Preliminary Report of the 1951 census, is not without interest, illustrating as it does the centrifugal tendency which London shares with all large cities.

* This report is published through the courtesy of the Mayor's Committee on Management Survey of the City of New York, at whose request the study of London finances was made by the Institute of Municipal Treasurers and Accountants. The report is printed as submitted by the Institute, except for minor editing and omissions from the chapters here published and for the omission of Chapters III (Local Authorities: Financing of Individual Services, including Specific Government Grants), V (Local Authorities: Administration Arrangements and Financial Control), and VI (Other Public Authorities in London). These chapters, omitted owing to lack of space, are projected for publication elsewhere.

Population	1881	1891	1901	1911
City of London	51,439	38,320	26,897	19,657
County of London (including City) ...	3,830,297	4,227,954	4,536,267	4,521,523
Greater London (including County) ...	4,766,661	5,633,806	6,581,402	7,251,358
Population	**1921**	**1931**	**1939**	**1951**
City of London	13,706	10,999	9,100	5,268
County of London (including City) ...	4,484,523	4,397,003	4,013,400	3,348,336
Greater London (including County) ...	7,488,382	8,215,673	8,728,000	8,346,137

The resident population of the City, which in 1631 was estimated to be 130,000 and in 1821 to be 128,000, has steadily dwindled until it consists mainly of caretakers. That of the County, reaching its peak in the early nineteen hundreds, has since steadily declined, a movement accentuated by the wartime evacuation. The population of Greater London itself now also shows a decline, although the outer ring, excluding the County, still shows some increase, and the adjacent areas are still growing.

THE AUTHORITIES TO BE CONSIDERED

The study is in general confined to local government services, i.e., to those services which are administered, for all or part of the area, by bodies confined in their powers to that area; services which are administered on a nation-wide basis will not be discussed. The types of authority to be considered fall conveniently into two classes:

a) The compendious local authority, which administers within its area a number of purely local services. These authorities are referred to as "*local authorities*" and the services they administer as "local authority services";
b) The "*ad hoc*" public authorities, each administering one service only within an area especially defined for that service, usually bearing little relation to the local authority areas or to the areas of other "*ad hoc*" authorities. These are referred to as "*public authorities.*"

A. *The Local Authorities*

In the English system of local government which obtains outside the County of London, certain of the larger urban authorities are constituted *county boroughs* and are responsible for all local government services within their area. The remainder of the country, including the adjacent counties of Essex, Hertfordshire, Kent, Middlesex, and Surrey, is divided into *administrative counties* which are responsible for the major local government services such as education, town planning, and highways within their area. These administrative counties are in turn divided into *county districts,* which are responsible for the more purely local services such as housing and refuse collection, and which may be either *rural districts, urban districts,* or *municipal boroughs.* These county districts are separate bodies and, although smaller, are in no way inferior to

the counties within which they are contained. The electorate of the county council is the sum of the electorates of the county districts contained within the county, but the county councils and the several county district councils themselves are separately elected and are completely independent of each other; they may, and often do, find themselves in conflict. If an individual lives in a county borough, therefore, he will be served by only one local authority for all local authority services; if he lives elsewhere, he will be served by the county council for some services and by the county district for others.

Within the County of London this two-tier system also operates, the authorities concerned being the London County Council, which is responsible for the major services, and the Metropolitan Boroughs and the City, administering the local services. The allocation of functions between the authorities is a little different from that outside London, and the powers and constitution of the Metropolitan Boroughs differ in several respects from those of the county districts.

Thus the local authorities which have to be considered are:

Within the County of London:

The London County Council
28 Metropolitan Boroughs
The City of London

Outside the County of London:

Five county councils, i.e., Middlesex and parts of Kent, Surrey, Essex, and Hertfordshire, each containing a number of county districts
Three county boroughs: Croydon, East Ham, and West Ham.

B. *The Public Authorities*

These are authorities which have been specifically constituted for the execution of one specific function within their defined area. Some are purely metropolitan and administer services which elsewhere in the country are administered in other ways; others are simply the metropolitan example of a general type and are in no way different from their counterparts in other parts of the country. In the first class we have:

1. The Metropolitan Police, responsible for policing the whole of Greater London, with the exception of the City of London, under the control of the Home Secretary exercising his powers through the Commissioner of Police. Outside Greater London the police forces are locally controlled by the appropriate county borough or county council.
2. The Metropolitan Water Board is responsible for water supply within an area covering most of Greater London. Elsewhere, water supply is in the hands of either the local authorities or private water companies.
3. The Port of London Authority, exercising jurisdiction over the tidal waters of the Thames, responsible for the docks and associated warehouses and services, and for regulating navigation on the river.
4. The Thames and Lee Conservancy Boards. These are responsible for land drainage and river control on the upper reaches of the Thames and the Lee, functions which elsewhere in the country are carried out by river boards. These river boards are of more recent creation than the Thames and Lee Conservancy Boards.

5. The London Transport Executive. This body, the successor of the London Passenger Transport Board, forms part of the nationalised system of British Transport, and is responsible for the omnibus, trolley bus, tram, and underground train services within an area larger than Greater London. The main line and suburban steam train services operated from main line termini are the responsibility of the various district executives, i.e., Eastern, Southern, Western and London Midland.

In the second class, London examples of authorities found elsewhere, are the following:

1. Gas Boards, responsible for the manufacture and supply of gas within their areas. These functions were taken over from local authorities and gas companies in 1949. All London north of the Thames falls within the area of the North Thames Gas Board, and South London within that of the South-Eastern Gas Board.
2. Electricity Boards, responsible for electricity distribution. These functions were taken over from local authorities and electricity companies in 1948. Parts of Greater London come under the Eastern, Southern and South-Eastern Boards.
3. Regional Hospital Boards. Each board is responsible generally for hospitals within its area. A Hospital Management Committee is responsible for day-to-day administration of each hospital or group of hospitals. The area of Greater London is divided between four Regional Hospital Boards and is administered by some twenty-five Hospital Management Committees.
4. Health Executive Councils. The medical practitioners, pharmaceutical, and optical sides of the National Health Service are administered through local Health Executive Councils composed of persons nominated largely by the Minister of Health. Although there is a certain amount of local interest, these are largely more agencies of the Ministry.
5. Various joint boards for different purposes, e.g., joint drainage boards, of which there are several in the area of Greater London, outside the London County Council drainage system, formed by local authorities in co-operation; joint crematorium boards for the provision of cremation, of which the chief is the Mortlake joint cremation board; and boards for other minor purposes.

Before considering in greater detail the services provided by all these authorities and the methods of finance, we would emphasise that all the *local* authorities are under the control of directly elected councils which are responsible to, and may be removed by, the electorate. The members of these councils are unpaid save for allowances for expenses and loss of earnings. The *public* authorities, on the other hand, are usually under the control of boards which are appointed either by local authorities or by Ministers or interested parties. They are not therefore directly controlled by the public.

The officers, who under the councils or boards are responsible for the running of services, are not political appointments and serve irrespective of the political complexion of their councils.

All the authorities considered are subject to the legal doctrine of *ultra vires*,

that is to say, they may not do anything which they are not expressly allowed to do by statute. They *must* perform their statutory duties; they *may* perform other permissive statutory functions, but they cannot go outside the powers laid down for them by general or special local Acts of Parliament.

Chapter II

LOCAL AUTHORITIES—MAIN SOURCES OF REVENUE

A. *The Rating System*

The main source of revenue of local authorities is the local rate, which is the only tax locally raised and is also the only tax over which local authorities have direct control. The authorities which levy and collect rates are the county boroughs and county districts. Counties are not rating authorities but obtain their revenue by "precepting" on the rating authorities within their boundaries, i.e., they require these rating authorities to collect on their behalf and pay over to them the produce of a specified rate in the pound, calculated according to estimates of the product of a penny rate. In county boroughs, therefore, the rate is levied and collected by the county borough council and applied wholly to its purposes; in county districts, including noncounty boroughs, the rate is levied and collected by the district council, but a substantial portion of it is handed over to the county council in payment of the county precept. Occasionally counties provide a service, e.g., public libraries, in only a part of the county, the county districts providing it in the remainder. In such cases the county council makes a "special county precept" requiring payments only from those districts in whose area it provides the service. In 1949-1950 the London County Council made a general county precept of 9s.1d. over all its area, plus a special county precept of 2d. on all the Metropolitan Boroughs but excluding the City which provided its own services in this case.

The London rating system is broadly the same as that operated throughout England and Wales. In most cases a property is assigned a gross value which is deemed to represent the annual rental value of the property concerned. A small deduction is made to allow for the annual cost of repairs and the resultant figure is the net annual value, normally equal to the rateable value, on which the rates are levied by the local authority. The very high rates now levied, in many cases over 20/– in the pound, seem at first sight oppressive, but we must point out that the levels of valuation are now out of date. The Rating and Valuation Act, 1925, provided for a quinquennial valuation but the one due in 1939 was postponed because of widespread complaints that to revalue property by using the full rental value would cause considerable hardship to many groups of ratepayers and particularly to those who occupied, either as tenants or occupiers, houses erected since the 1914-1918 war. No valuation has been possible since that date. Consequently it is now almost twenty years since property was revalued; the vast increase in property values since then has made many of the present valuations inadequate, and this must be borne in mind when considering the high rate levels which exist. The rating system allows for adjustments of valuations in special circumstances between the quinquennial review, but this has been used for isolated assessments and not for general application.

The principle of valuation outlined above has been amended during the years for administrative and other reasons and has now some important modifications. Most important are the total derating of agricultural hereditaments and the 75 per cent derating of industrial hereditaments. The former is of little importance in the case of London (although there are agricultural hereditaments in the metropolitan borough of Woolwich), but the latter is most important and is the subject of considerable controversy at the present time. Industrial derating, as it is called, was originally introduced in 1929 to help industry combat the effect of the slump by relieving it of the " dead charges " of rates. In fact, its net effect was small and many people consider it has outlived any usefulness it had. In an industrial centre such as London the abolition of derating would add an appreciable sum to the area's rateable value and considerably broaden the income resources of the authority concerned. As some indication of the gain in rateable value which would accrue, it may be remarked that on the introduction of derating in 1929, the London County Council lost £2,821,085 in rateable value, i.e., about 5 per cent of the total rateable value in 1929.

Recently, under the Local Government Act, 1948, there has been a radical alteration in the method of valuation of small dwelling houses. The scarcity of houses in the postwar years, plus the existence of rent control, had made any assessment of fair rents difficult, if not impossible, and the new method has been introduced to resolve this difficulty. The new valuations were expected to come into force in 1953 but it has recently been announced that they are likely to be delayed. They will probably result in considerable increases in assessment for all but industrial hereditaments. All figures quoted in this report are based on the present assessments which have been made on the old basis. The new method has recognised that the present scarcity of dwelling houses makes the rental-value basis of valuation unworkable for smaller properties, and substitutes the following:

Class A. Local authority or housing association houses built after 1st April, 1919—5 per cent of the hypothetical 1938 cost of construction of houses and appurtenances *plus* 5 per cent of the hypothetical 1938 site cost.

Class B. Privately built houses erected since 1919 and having in 1939 a rateable value not exceeding £75 (£100 in City of London and in the Metropolitan Police district)—5 per cent of the hypothetical 1938 cost of construction of houses and appurtenances *plus* 5 per cent of the value of the site on 1st April, 1949.

Class C. All houses erected before 1919 and all privately owned houses having a rateable value in 1939 of over £75 (£100 in City of London and in the Metropolitan Police district) whenever erected—either the rents charged for comparable houses in 1939, or, where there is a lack of such comparable houses, the rent at which the hereditament might reasonably be expected to let from year to year in 1938. In other words, the previous basis of

valuation continues to apply to these properties, but is related to the *prewar* level of rents.

Class D. Property other than dwelling houses—the basis is to be, as previously, current valuations of rental as from time to time existing.

There are other minor classes but these main ones give the new principles of valuation applying in England and Wales. We would particularly stress the high proportion of rates paid by residential and business, as distinct from industrial, premises.

This then is a brief picture of the valuation system, a cause of lively dispute at the present time. The rating system might be said to be only the mechanics of collecting rates made on the rateable values allotted by the valuers. The rates are fixed by each metropolitan authority (within the area of the London County Council) annually (or half-yearly) to meet the precept of the London County Council and their own estimated expenditure. Local authorities are required by law to levy a rate to meet all estimated expenditure and are prohibited from levying a rate in excess of their requirements, other than for the provision of a reasonable working balance. Once the estimated expenditure has been sanctioned, the rate to be fixed is consequently confined within very narrow limits.

The administrative details of rate collection are comparatively simple. Complete exemption from rates is given (but not in the City) when premises are unoccupied. Authorities have found that the rates of rented houses are collected more easily from the owners than the occupiers and are empowered by legislation to force, or to agree with, owners to pay the rates on behalf of occupiers and to collect them from the occupiers. Authorities are empowered if they wish to grant a special allowance to the owners concerned. A considerable proportion of the rates are collected from owners in this way, sometimes without any allowance being made to the owner.

Following nationalisation, electricity and railway and canal hereditaments have now been derated. The government distributes to local authorities the total sum previously collected by them, adjusted for changes in the finances of the undertakings and in the level of local rates, in proportion to the total rateable values of all properties in each of the areas.

The inadequacy of the present valuation levels and the greatly increased expenditure on education and other services administered locally have forced rates up to a high level, and many people have suggested alternative sources of local revenue, e.g., a local income tax or city taxes on the American model. But the present rating system will probably continue to be the basic source of income for local authorities who are, however, being forced to rely more and more on government grants which in 1948-1949 totalled £284,400,000. In that year the expenditure falling on rates was only £270,800,000. This large percentage of government aid has naturally brought with it an increasing central control, and there is a danger that local authorities throughout the country may be losing their financial independence.

Rather similarly, many county districts feel that they are becoming too

dependent on the county council, and the distribution of services is now becoming heavily weighted in favour of the county council. Thus in 1949-1950 the London County Council precept was 9/3d., whilst the average metropolitan borough rate was only 7/7d. In other counties the county council proportion is greater; in 1950-1951 the average Middlesex County Council precept was 12/1½d. and the average county district rate 6/–.

B. *The London Equalisation Scheme*

The London equalisation scheme, which operates in the County of London only, was devised in an attempt to rectify the inequalities in rate burden within the county, and it results in the richer boroughs contributing to the expenses of the poorer. The criterion of wealth is rateable value per head in the same way as with the equalisation grant formula to be discussed shortly, but population is weighted so as to take account of the industrialisation of the borough concerned. The weighting factor used is the net annual value divided by the rateable value. A word of explanation is necessary here on the difference in meaning between these two terms. Normally they are identical but, for industrial premises, the net annual value is the figure before the deduction of the 75 per cent derating allowance. The final figure, equal to 25 per cent of the net annual value, is the rateable value, so the effect of the derating of industrial property is to make the rateable value of industrial areas very much less than the net annual value.

In the London scheme the population of each metropolitan borough is multiplied by the above factor, i.e., net annual value divided by rateable value. To the boroughs whose rateable value per head of population so weighted is below the average for the county, a payment is made by the county council, being a proportion of the borough's local net expenditure (i.e., the expenditure on its own services) dependent on the extent to which its rateable value per head falls below the county average. (It should be added that there is a limiting clause in the scheme which excludes from grant either local expenditure in excess of the county average per head of population or local expenditure which has risen more rapidly since 1947-1948 than that of the boroughs generally.) To provide funds for the total of these grants, *all* the boroughs and the City pay contributions proportionate to their penny rate products.

As a result of these transactions, there are at present eight boroughs who make contributions without receiving any grant (Chelsea, Finsbury, Hampstead, Holborn, Kensington, St. Marylebone, Westminster, and the City), the contribution being the equivalent of a rate of 1/9d. in 1950-1951 and 1951-1952. Two boroughs (St. Pancras and Paddington) pay more by way of contribution than they receive by grant; the remaining nineteen boroughs all receive more by way of grant than the contribution they have to make, the net relief to the rates in 1951-1952 being the equivalent of a rate varying from 4½d. in the £ for Wandsworth to over 10/– in the £ for Poplar. The measure of equalisation of rates achieved by this scheme is fairly considerable; before the inauguration of the scheme in 1947-1948, rates in the county ranged from 11/– (Westminster) to 23/– (Bethnal Green), but in 1948-1949 after the scheme was instituted, the range was from 13/6d.

(Westminster) to 19/4d. (Poplar), a decrease in range from 12/– to 5/10d. A secondary result of the scheme is that when the council of a receiving borough elect to embark on expenditure, the councils of all other boroughs help to pay for it without any choice in the matter, subject to the limiting factor mentioned above which has already begun to operate.

C. *The Exchequer Equalisation Grant*

The exchequer equalisation grant, the main government grant paid to local authorities, is perhaps second only in importance to rate income as a source of revenue. We have, however, preferred to deal with the London equalisation scheme first because that is of more importance in the financing of the government of London.

This feature of metropolitan finance is absent from that of provincial authorities, but there is in its place this other and far more important system of aid for poorer authorities. The exchequer equalisation grant is a direct grant to assist authorities which are "poorer" in terms of rateable value, and it includes a slight weighting for areas which have a large number of small children or which are sparsely populated. The formula for its calculation is as follows:

1. The population of the authority concerned is increased by the number of children under fifteen years of age, and, in counties where the density of population per mile of road is less than 70, one-third of the additional population required to bring the density up to that figure. The adjusted figure is known as the "weighted population."
2. The national average rateable value per head of weighted population is calculated, and this figure is multiplied by the weighted population of the authority concerned to give the rateable value which that authority would have if it were up to national average. This figure is known as the "standard rateable value."
3. The actual rateable value, if less than the standard rateable value, is deducted from the latter, and the difference is known as the "credited rateable value."
4. The grant payable is then calculated as follows:

$$\text{credited rateable value} \times \frac{\text{relevant expenditure}}{\text{credited rateable value } \textit{plus} \text{ the product of a rate of 20/– in the £.}}$$

The "relevant expenditure" is the total expenditure which would fall to be borne by rates if no grant were receivable.

In view of the importance of this grant, the following example of its application may be useful.

Let us assume that the rateable value of a town with a weighted population of 100,000 is £400,000 and that the amount of income which it is necessary to raise by rate is £200,000. The rate to be levied is therefore 10/– in the £. If, however, the national average is a rateable value of £5 per head, the rateable value of the town in question falls short of the national average by £1 per head, and the additional rateable value required to bring the town up to the average is £100,000. The Government will therefore pay the rates on £100,000 as equalisation grant, and the rates, now levied on a rateable value of £500,000, can be reduced to 8/– in the £; of the

total expenditure of £200,000, the ratepayers are now paying £160,000 and the Government £40,000. This explanation perhaps shows the principle of the formula better than a mere arithmetic example, which would appear as follows:

Standard rateable value: £5 × 100,000 = £500,000
Actual rateable value = £400,000

Credited rateable value £100,000

Grant payable:

$$\pounds 100{,}000 \times \frac{\pounds 200{,}000 \text{ (expenditure)}}{\pounds 100{,}000 \; plus \; 400{,}000} = \pounds\ 40{,}000$$

In this example we have ignored the effect of the weighting factor upon the population and the fact that, due to losses in, and costs of, collection, a rate of 20/– in the £ will normally be less than the rateable value upon which it is assessed.

This grant, which puts the exchequer in the position of paying rates on the amount by which the rateable value of an authority falls short of the national average per head of weighted population, is paid to counties and county boroughs only and achieves a large measure of equalisation of resources within these classes of authorities. A separate computation is made for each county and county borough. It should be noted that authorities with a rateable value per head *above* the national average are not penalised in any way.

The exchequer equalisation grant paid to a county takes into account the relative poverty or otherwise of its county districts, and no direct grant of this type is paid to the districts. Each county, however, is required to pay a fixed capitation grant to every district within its administrative area. These grants vary slightly from year to year but are at present approximately 15/6d. per head of population to urban districts and half that amount to rural districts (these receive a smaller grant because their responsibilities are fewer). Every county (except London) has to pay these capitation grants whether or not it receives an equalisation grant and makes a precept to cover this cost. As the income raised by the precept is proportionate to the rateable values of the individual authorities and the payments made are related to their populations, there is a slight degree of aid given to the authorities with a low rateable value per head of weighted population.

This equalisation grant system applies in all local government areas in England and Wales and is in some respects similar to the London equalisation scheme, but there are two important differences. The London scheme is merely a redistribution of resources between authorities and no subvention is received from the national exchequer, whereas the equalisation grants paid to local authorities in 1950-1951 total almost £50 million. Secondly, the London scheme attempts to equalise resources with the constituent districts, but the equalisation grant system only does so between counties and county boroughs, with the capitation grants creating a small, but very imperfect, adjustment between county districts.

London is a wealthy area and so does not receive any grant. Of the adjacent authorities, Hertfordshire, Kent, Middlesex, and Surrey Counties and Croydon county borough receive nothing, whilst Essex County receives 6.67 per cent of its own net expenditure and the total expenditure of its constituent county districts, and the county boroughs of East Ham and West Ham 16.55 per cent and 10.33 per cent respectively, in 1949-1950.

Chapter IV
CAPITAL FINANCE

Local authority expenditure which results in the production of a permanent asset is regarded as capital expenditure and is normally financed by borrowing. In order to reduce interest charges, many local authorities make a practice of financing a proportion of capital expenditure from revenue, especially if only small sums are involved; for example, the London County Council sets aside out of revenue each year the sum of at least £250,000 for capital expenditure and the accelerated repayment of debt, and in addition usually finances small capital works from revenue. Conversely, expenditure which is not strictly capital may be financed by borrowing if the sums involved are too large to be conveniently charged to revenue in one year. On balance, the greater portion of capital expenditure is financed from loan and the interest and repayment charges constitute a fairly substantial revenue charge. In the London County Council area, this amounted to about £9,500,000, or over 10 per cent of total expenditure in 1948-1949. In 1949-1950 the total capital expenditure of the London County Council was £21,500,000. The two largest components were almost £18,000,000 on housing and £1,600,000 on education.

Apart from limited borrowing by means of short-term mortgages, there is at present only one method of borrowing new money open to local authorities, namely, to borrow from the Public Works Loan Board—an organisation which receives its funds from the Treasury and lends at present at comparatively low rates of interest. This restriction, which was imposed in 1945 by the Local Authorities Loans Act, was designed to prevent local authorities competing for money in the open market, thought to be one of the main causes for the high rates of interest prevailing after the 1914-1918 war. This restriction, originally imposed for five years, remains in force, and will probably be maintained for some time to come, but it does not appear likely to be renewed indefinitely. Most of the outstanding prewar debts of local authorities came from other sources of borrowing. The chief ones (ignoring temporary loans by way of bank overdraft etc.) are:

1. Mortgage loans repayable by annual instalments, either on the annuity or equal instalment system.
2. Mortgage loans repayable at maturity, either short-term (say five to ten years) or long term.
3. Stock quoted on the Stock Exchange.
4. Borrowing from internal sources, e.g., a superannuation fund or reserve fund.

The instalment loans are most favoured by the small authorities as they are comparatively easy to manage. It is a statutory requirement that local authorities borrowing money for capital purposes must repay the loan within a period of time not greater than the expected life of the work, and to comply with this requirement an annual charge is made to the revenue account of the service concerned equal to the interest on the loan, together with a repayment instalment. The instalment loan fits in very well with this requirement as the loan charges can be repaid directly to the lender with a minimum of bookkeeping entries; for the larger authority, however, more freedom is given if other

methods of borrowing are employed: advantage can be taken of lower rates of interest and there is access to a larger market. Such authorities, therefore, have in the past made large stock issues and have borrowed extensively on maturity loans.

In the case of authorities using these methods of borrowing, it is impossible to associate the revenue repayments by the borrowing services with the actual repayments to the lenders, and it is necessary to set up some form of mechanism such as loan funds, sinking funds, or mortgage pools, into which the borrowing services make their repayments and from which the lenders are in due course repaid. Pending use for repayment, the money in these pools is frequently used for fresh capital purposes.

The fourth source of loans is internal borrowing. Local authorities may hold large balances on such funds as superannuation funds, insurance funds, or repair funds which have been built up to meet future contingencies, and loans are frequently made from these funds to other services at current rates of interest.

Control over borrowing is by means of the " loans sanction " procedure. No local authority may borrow money until it has the sanction of the competent authority, usually the Minister of Local Government and Planning, and before giving sanction the Ministry usually examines the proposed scheme in considerable detail. In the case of the London County Council, loan sanction is replaced by an annual Money Act approved by Parliament, the schedule to which sets out the capital purposes for which borrowing is approved. Failure to obtain approval to a loan does not mean that the local authority cannot carry out the work, but it *does* mean that if the work is done, it must be financed from revenue, and this is the course which the London County Council adopted when permission to borrow for the reconstruction of Waterloo Bridge was refused by Parliament.

Two other controls over borrowing must be mentioned:

These are Treasury control and Public Works Loan Board approval. As part of the general control of capital issues, the Treasury has to approve almost all local authority borrowing (except from internal sources) whilst local authorities wishing to borrow from the Public Works Loan Board have to obtain Loan Board approval to the loan; before giving this the Board normally requires to be satisfied that the money cannot be raised elsewhere and that the authority is " credit worthy."

Borrowing within the County of London is in no way different from borrowing outside, the operations of the London County Council differing only in size from those of other authorities. Before the war the metropolitan boroughs went to the county council for a large proportion of their loans as the county was able to obtain better rates of interest, but for the moment the boroughs are restricted to the Loan Board.

Chapter VII

CONCLUSIONS

We have tried to describe in detail the various functions of local government and the various public boards and bodies administering special services in London. It will be seen that the financing of these services is considerably more uniform than their administrative

areas. Setting them out in tabular form, the main sources of finance are:

Local Authorities in London County Council Area	Sums received from rates (including precepts), specific government grants, minor local revenues, and, in certain cases, contributions from the London Equalisation Scheme.
Other Local Authorities in Greater London	Sums received from rates (including precepts), specific government grants, minor local revenues, and, in certain cases, exchequer equalisation or capitation grants.
London Transport	In theory, self-supporting from fares charged. Part of national transport system. No contributions from or subsidies to local or central government funds.
Metropolitan Water Board	Self-supporting from water rates levied on occupiers of property.
London Electricity	Self-supporting from charges made. Part of national organisation. No contributions from, or subsidies to, public funds.
London Gas	As for Electricity.
Metropolitan Police	Administered by special organisation which makes a precept on local authorities to meet half the cost, the other half being met by the Exchequer.
Health and Hospital Services	Administered by the Minister of Health through Local Health Executive Councils and Regional Hospital Boards (and Hospital Management Committees) respectively. Financed from national revenue.
London Postal Services	Part of the national postal system, which is self-supporting.

These services fall into two main classes. Local government services and the Metropolitan Police are financed out of rate revenue together with Government grants; transport, water, electricity, gas, postal, Port of London, and conservancy services are financed out of charges made to the consumer, although in some cases, such as water, these charges are collected by way of rate or precept. The administering bodies for these services all have different areas which are more usually designed to fit into the national administrative pattern for the service, but sometimes, as for Police and Water, have been the result of a conscious attempt to decide on the best administrative size for London. In all these cases the services are self-supporting and are independent of any government or local authority subsidy, nor do they make contributions towards any national or local service. The Health and Hospital Services are maintained by the state.

This pattern of London government—on the one hand, local services and national welfare services met out of local or national tax revenue, on the other, self-sufficient public utility undertakings operated independently by public bodies—has become more pronounced in recent years. The transfer of water and, outside London, transport have

taken and are taking away the only outside source of revenue of local authorities, the profits made from trading undertakings. Evidently they will have to rely more and more on rate income and government grants. The present local government structure in London is working well and, in these days of inflation, at a reasonable cost. The severance of public utility undertakings may be a loss to local authorities but at least the undertakings are financially as well as administratively independent and the various services, especially water, electricity, gas, and transport, are operated without any charge to public funds. The independence of these bodies perhaps narrows the sources of revenue available to each and restricts transfers between services, but it also helps to make sure that each pays its way.

A more troublesome question is the housing of the population of London. The recent census, whose figures are presented in Chapter I, has shown that the population in the London County Council area was reduced by nearly 25 per cent between 1931 and 1951, whilst that of Greater London also decreased slightly and those of the adjacent counties increased sharply. This shows that the drift to the outskirts continues and in turn raises many social problems. Is London becoming too big? Is too much time spent travelling to work? Is it right that suburban ratepayers should enjoy the facilities provided in their workplace in London by a metropolitan borough towards whose expenses they make no contributions? There are many others too, but they will be equally present in New York.

One attempted solution since the war has been to build new towns fifty miles or so away from the centre of the metropolis and to seek to transfer industries to them, thus creating independent new communities having their own business and commercial structure. New towns have been established in other parts of the country also, but seven of the eleven under construction have been placed to relieve London. Their construction has been necessarily slow and expensive and, up to the 31st March, 1950, the seven new towns near London had cost over £5,000,000. From evidence of their progress to date their effectiveness seems limited, and they may not solve the problem of London expansion.

The congestion in the London County Council area, and in Greater London also, is creating housing difficulties. The London County Council has in many cases to build its houses and flats outside its area, with a heavy burden on its own dwindling number of ratepayers, and a burden also on the receiving authorities. This is a national problem, and it was announced in Parliament at the end of July, 1951, that the Government is intending to introduce legislation to give special grants to assist boroughs and district councils who take in "overspill" population from big towns adjacent to them. This will be welcomed by local authorities, but is another example of how their financial difficulties are being resolved more and more by increased Government grants with a consequent increase in their dependence on the central government.

We should mention that in 1945 a Local Government Boundary Commis-

sion was established to investigate the whole local government structure of England and Wales, except the London area. Its rather drastic recommendations were not accepted by the Government and it was dissolved. There is a great need for some review of local boundaries both in and out of London, but the present delicate political position makes it unlikely that so thorny a problem will be tackled. The size of some of the county districts in the London area is now becoming embarrasing. Many have populations of over 100,000, several over 150,000 and at least one, Harrow, over 200,000. The recognised population for a county borough, however, is 75,000-100,000. Their nearness to London makes it unlikely that they will ever be granted county borough status and yet their size is upsetting the balance of the normal county–county district relationships.

To sum up, London government has no special problems of financial administration. The various public boards are self-sufficient and give good service for reasonable charges. The one service not self-sufficient, Health and Hospitals, is so for reasons of policy and is a national responsibility which compares with the provision of the armed forces rather than with local administration. The local authorities are financially sound but have no source of income other than rates and government grants, and the narrowness of their resources is forcing them to depend more and more on government grants. This is not peculiar to London and is perhaps not a serious defect, especially since the greater part of local authorities' expenditure is on national or seminational services. In any case, this is perhaps a domestic problem rather than one for international comparison.

A NEW PROPOSAL FOR EMERGENCY TAXATION OF CORPORATE PROFITS

HAROLD M. GROVES AND DON M. SOULE [*]

THE Excess Profits Tax Act of 1950 meets heavy criticism on the score that it is unduly complicated, capricious, and repressive. Yet the tax has strong support on the grounds of revenue and as a feature of a broader system of inflation control. The case for the tax in equity, as we shall seek to show, is confined to the fact that the "emergency" creates excess profits for some corporations but not for others. It is our purpose here to show that the excess profits tax could be confined to a much smaller area with salutary results and that an increase in the corporation income tax could be substituted for much of it.

The Proposal

The 1950 excess profits tax bases normal profits mainly on 83 per cent of base-period average earnings and thereby defines as excess not only the increases in profits over base-period earnings but also a part of base-period earnings.[1] The rationale of the 83 per cent is that part of base-period earnings were excess and that these excess profits continued to be earned during the emergency. Increases over base-period earnings also are of two classes; some increases are shared in by all corporations, while some corporations earn a greater than average share of the increased profits. It is possible, therefore, to divide corporate profits into the following four categories:

(1) Normal profits: these are defined by law to be 83 per cent of average earnings in the three best years of the base period 1946-1949 (with qualifications).

(2) Excess profits equivalent to those earned in the base period: these are earnings in the range of 83 to 100 per cent of base-period earnings as defined.

(3) General earnings in excess of those in the base period: these are equivalent to the average increase in the earnings of all corporations over the base-period experience.

(4) Special earnings in excess of those in the base period: these are earnings in excess not only of base-period earnings but in excess also of the average increase in earnings of all corporations. These increases will be referred to as "differential" profits or gains.

* The authors are both members of the department of economics at the University of Wisconsin. Harold M. Groves is professor of economics, and Don M. Soule is research assistant in economics.

1 There are four other methods of computing normal profits, but the average earnings credit is the principal measure of normal profits. The other credits, including the invested capital credit, provide relief for corporations with low base-period earnings.

To illustrate, if the A corporation, with constant capital, had profits of 100 in the base period and 125 in the current year, and if the current-year average earnings of all corporations were 115 per cent of base-period earnings, the profits of the A corporation could be divided into the four categories as follows:

(1)	83
(2)	17
(3)	15
(4)	10
	125 total

The present method of taxing corporate profits applies the corporation income tax to category (1) and the excess profits tax to categories (2), (3), and (4). Our proposal is to confine the excess profits tax to category (4) and to shift categories (2) and (3) to the corporation income tax. In the above example the base of the excess profits tax would be reduced from 42 to 10, and the rate of the corporation income tax would be increased so that the total yield of the two taxes would remain constant.[2] To meet the popular demand for a tax on " war profiteering," the increase in the corporation income tax should be kept separate from the regular corporation income tax and should have a special name such as " war profits tax."

[2] In a hypothetical universe of seven corporations, (with constant capital) each with base-period earnings of 100 and current-year earnings of 80, 100, 120, 140, 160, 180, and 200 respectively, each corporation's normal profits would be 140 under the proposal instead of 83 as under the 1950 act, and the yield of the excess profits tax would be reduced from 120.60 to 36. Six corporations would pay an excess profits tax under the 1950 act, while only three would pay under the proposal, and the yield of the excess profits tax would be reduced by 70 per cent.

The Existence and Significance of Differential Profits

Corporate profits increase during a war or similar emergency, and it is generally believed that these increased profits are unearned or windfall profits and an especially suitable subject for taxation. This special taxation takes the form of an excess profits tax rather than an increase in the corporation income tax because it is believed that the special tax should be applied only to those corporations which earn increased profits. An increase in the corporation income tax would be appropriate only if all corporations shared proportionally in the increased profits, but the existence of differential profits makes it necessary to divide corporations into two groups, those earning normal profits and those earning excess profits, and to apply the excess profits tax only to those corporations earning excess profits.

The principal measure of normal profits is base-period earnings, but this measure is inappropriate in that it does not allow for the fact that all corporations share, in various proportions, in the increased profits earned during an emergency. A period of defense spending is a period of rising incomes (and often inflation), and it helps the chewing gum manufacturer as well as the aircraft company. Although defense expenditures are confined to defense industries in the first round of spending, the increased incomes created by these expenditures are diffused throughout the economy on the second round. For example, the workers in defense plants spend their wages on food, clothing, etc. Therefore, a suitable measure of normal profits would be base-period earnings adjusted for the average increase in the profits of

all corporations in the emergency year, and excess profits would be those earnings in excess of base-period earnings adjusted for the average increase in the profits of all corporations in the emergency year. That is, only differential or nongeneralized increases in profits would be regarded as excess profits.

The question naturally arises as to whether these differential profits actually exist and how significant they are. To gather a more accurate conception of the differential effects of war spending and inflation, the authors sought empirical evidence in a study of a considerable number of corporation earnings records in *Moody's Industrials.* The data of this study are submitted and explained in the following paragraphs. The conclusion is that differential gains attributal to or associated with inflation and defense spending are far less marked than might have been supposed. But they are not negligible. As previously stated, our proposal is to isolate these differential gains to create a new, a legitimate, and a relatively minor area for the excess profits tax.

The net incomes of 115 corporations for the seven years 1945-1951 and of 18 of these corporations for the 20 years 1932-1951 were obtained from *Moody's Industrials.* Net incomes were before federal income and excess profits taxes and, in order to account for the changes in invested capital, net incomes were expressed as percentages of net worth (total assets minus current liabilities and other debts or, alternatively, the sum of capital stock, surplus, and other forms of undistributed profits used in the business). Net worth for any one year was the average of net worth at the beginning and at the end of the year.

On the theory that an increase in the corporation income tax could be used instead of an excess profits tax if the changes in profits were uniformly distributed among all corporations, only *relative* changes in a corporation's profits were considered relevant. In order to remove the changes in the average level of profits of all corporations, the earnings of each corporation were expressed as percentages of the average earnings of 115 corporations. That is, the earnings of each corporation were expressed as index numbers, using the average earnings of 115 corporations as the base and equal to 100 per cent. For example, if 115 corporations earned an average of 18 per cent on net worth in a given year, and Corporation A earned 16 per cent on its net worth, the index number of Corporation A's earnings would be 88.9 per cent (16 divided by 18, multiplied by 100). If Corporation B lost 16 per cent on its net worth, its index number would be –88.9 per cent. If Corporation C earned 36 per cent on its net worth, its index number would be 200 per cent.

By removing the changes in the average level of profits of 115 corporations, the index numbers show *relative* changes in profits instead of *actual* changes in profits. For example, if the average earnings of 115 corporations were 20 per cent in 1950 and 30 per cent in 1951, and the A Corporation earned 10 per cent in 1950 and 15 per cent in 1951, the A Corporation's relative earnings would be 50 per cent in both years. Although this corporation would have an increase in actual earnings, it would have no increase in earnings relative to the average earnings of 115 corporations.

The 115 corporations used in the empirical study consisted of five corporations from each of 23 industries. The 23 industries can be divided roughly into three groups. Most of the corporations in the first group of eight industries (of which Graph I is representative) had no significant changes in relative earnings in 1950-1951. The second group of seven industries (of which Graph II is representative) contains some corporations which had significant changes in relative earnings in 1950-1951, but most of these increases were not unusual when compared with the 1946-1949 experience. The final group of eight industries (of which Graph III is representative) contains corporations which had increases in relative earnings in 1950-1951 which might be classed as excess profits. The relative earnings of six of the 18 corporations studied over a period of 20 years, presented in Graph IV, show that the present emergency period is very similar to a war period and that profits fluctuate as much during nonwar years as during war years.

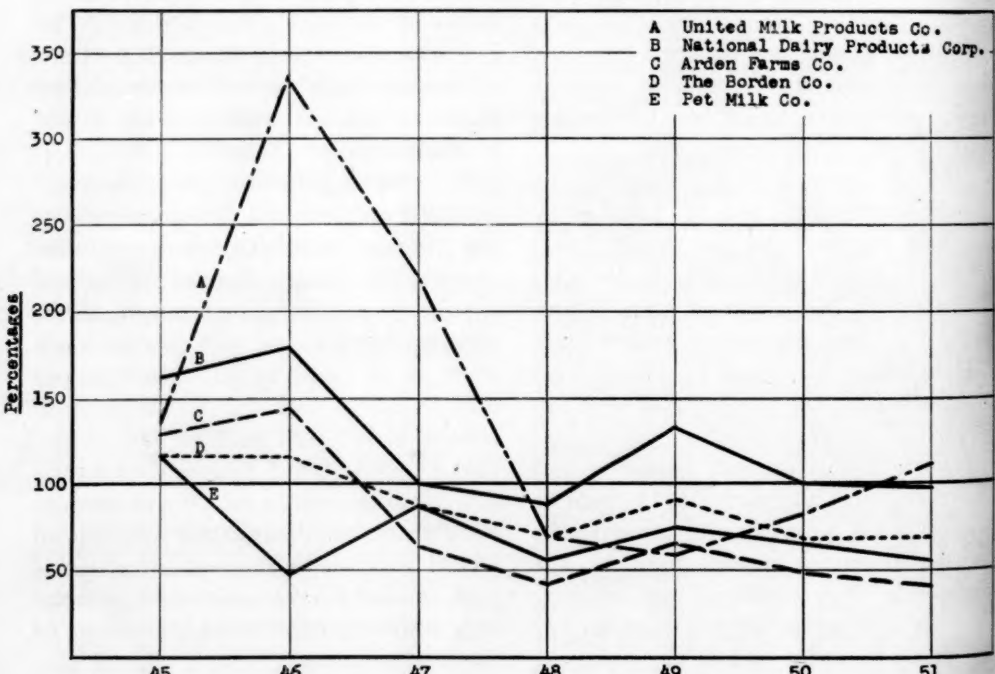
Graph I shows a significant increase in 1950-1951 relative earnings only in the case of the United Milk Products Company, but its 1950 and 1951 relative earnings were still much lower than its 1946 and 1947 relative earnings. In Graph II the Keystone Portland Cement Company had a significant increase in relative earnings in 1950-1951, but this

GRAPH I

MILK PRODUCTS

NET INCOME AS A PERCENTAGE OF NET WORTH

(Expressed as index numbers: average of 115 corporations equals 100 per cent)



Source: Moody's Industrials

increase was smaller than the increase from 1947 to 1948 and therefore may be judged not necessarily to have been caused by the emergency. Four of the five corporations in Graph III had higher relative earnings in 1950-1951 than in the base period, although some of the rates of increase were no more unusual than some base-period increases. But all of the five corporations in Graph III had slightly increased relative earnings in 1950-1951, and we must conclude that the chemical industry was affected by the emergency and that a small amount of excess profits was earned.

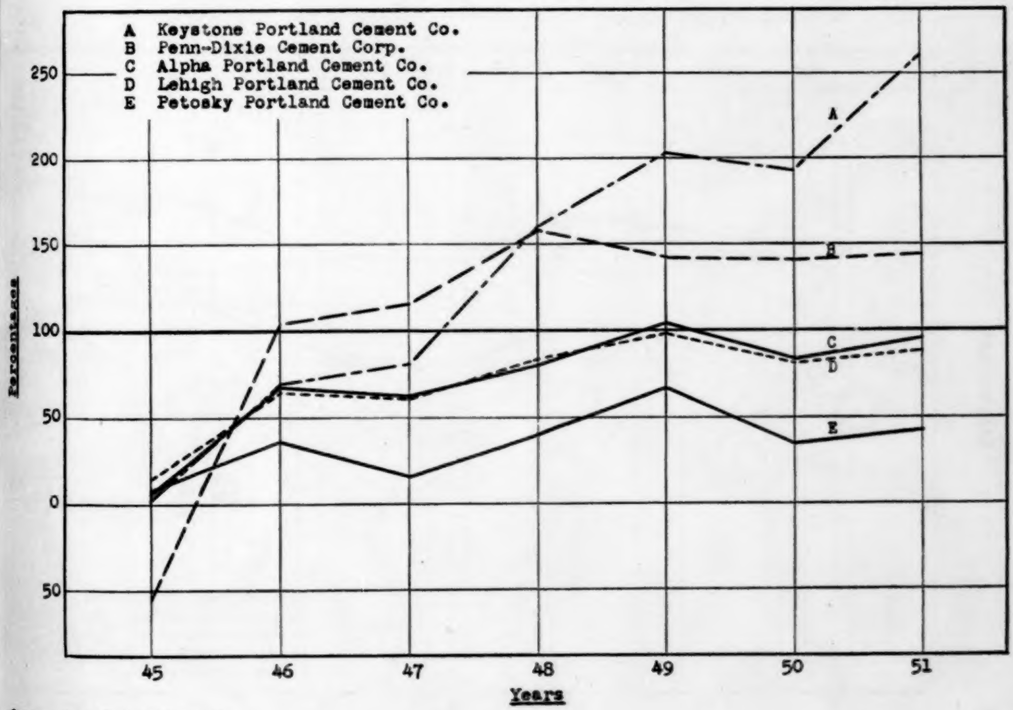
The study of 115 corporations over a seven-year period, as well as the study of 18 corporations, has shown that profits fluctuate within the same firm from year to year, between firms within the same industry from year to year, between industries from year to year, and the average level of profits of all corporations as a whole fluctuates from year to year. Profit fluctuations are virtually the same in nonwar years as in war years, and they are as great in the present emergency period as in World War II. Although differential profits (increases in relative earnings) are far less marked than might have been supposed, some differential profits do exist and they are not negligible.

GRAPH II

CEMENT PRODUCTS

NET INCOME AS A PERCENTAGE OF NET WORTH

(Expressed as index numbers: average of 115 corporations equals 100 per cent)



Source: Moody's Industrials

New Method of Computing Excess Profits

The proposed method of taxing corporate profits during a war or similar emergency would apply the excess profits tax to only that part of a corporation's profits which exceeded its base-period average earnings adjusted for the increase in the average earnings of all corporations in the current year. A simple method of isolating these differential profits would be to convert base-period earnings and current-year earnings into index numbers as utilized in the empirical study. If a corporation's average earnings in the base period were 80 per cent of the average earnings of all corporations in the base period, its excess profits credit in any emergency year would be 80 per cent of the average earnings of all corporations in that year. If the average earnings of all corporations in any emergency year were 150 per cent of base-period earnings, each corporation's credit would be 150 per cent of its base-period earnings.

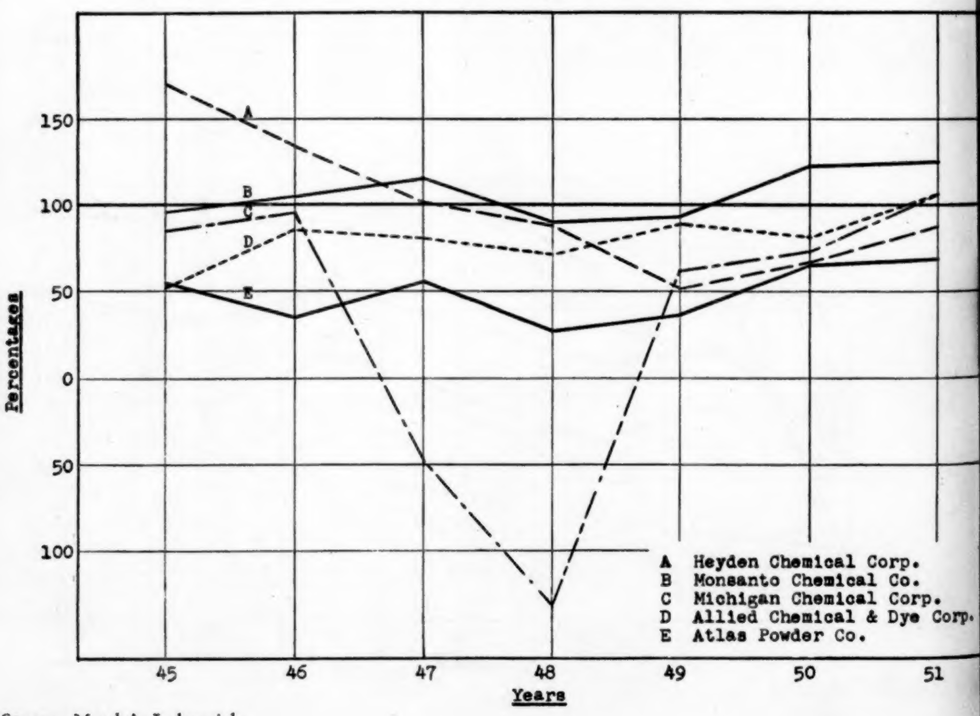
To compute a corporation's excess profits, the first step would be to compute its net income as a percentage of net worth in each base-period year. Next, its net income (expressed as a percentage of net worth) would be expressed as a percentage of the average earnings (expressed as a percentage of net worth) of all corporations in each

GRAPH III

CHEMICAL PRODUCTS

NET INCOME AS A PERCENTAGE OF NET WORTH

(Expressed as index numbers: average of 115 corporations equals 100 per cent)



Source: Moody's Industrials

base-period year. Data on the average earnings of all corporations would be supplied by the Treasury Department. The third step would be to average the corporation's three highest index numbers in the base period to obtain its excess profits credit expressed in index numbers. The fourth step would be to multiply the credit (expressed in index numbers) by the average earnings (expressed as a percentage of net worth) of all corporations in the current year. This would give the corporation's excess profits credit expressed as a percentage of net worth. The fifth step would be to multiply the corporation's net worth in dollars by its credit (expressed as a percentage of net worth), and the product would be its credit expressed in dollars. Any profits above this credit would be excess profits.

Argument:

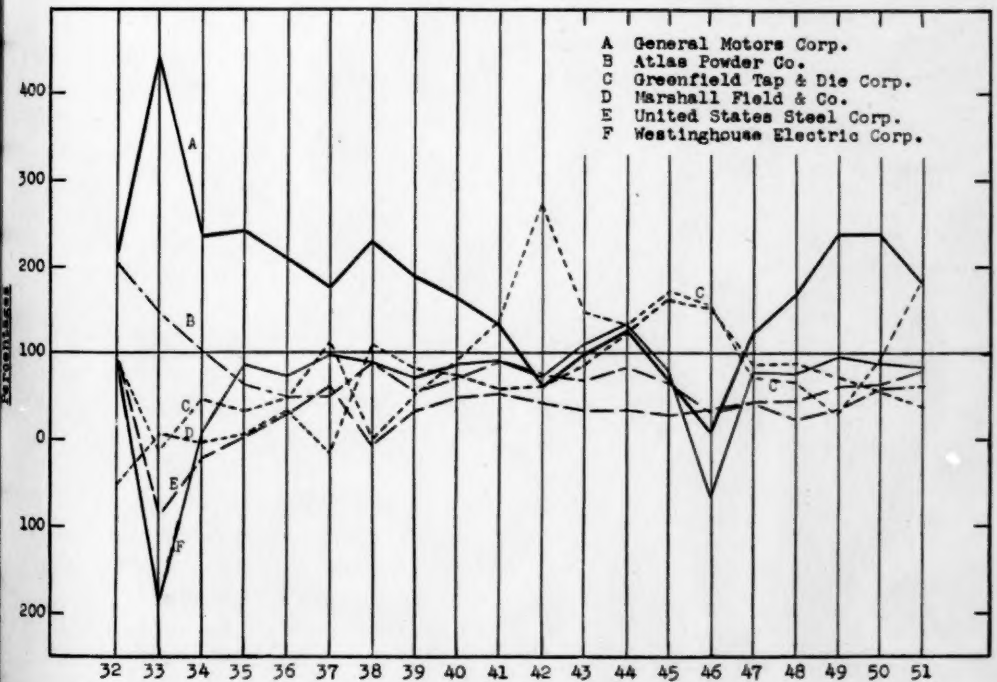
The main advantage of our proposal has already been stated in part; it would reduce the area of coverage of the excess profits tax by about 50 per cent and would reduce its yield approximately 70 per cent without radically changing the incidence of the total tax on corporate profits.[3] Decreasing the importance of

[3] These estimates of the reduced importance of the excess profits tax are based on the hypothetical example mentioned in footnote 2, and although they are reasonably accurate, they are not intended to be definite estimates of the revenue implications of our proposal.

GRAPH IV

NET INCOME AS A PERCENTAGE OF NET WORTH

(Expressed as index numbers: average of 18 corporations equals 100 per cent)



Source: Moody's Industrials

the excess profits tax would substantially reduce the multitude of problems and complications arising out of administration, compliance, relief, and litigation mainly because fewer corporations would be subject to the excess profits tax, but also because it would be possible to write a less complicated excess profits law if it were assigned only a minor role in the tax system.[4] That base-period average earnings are a crude measure of normal profits is evidenced by the widespread opposition to the excess profits tax, the numerous litigations which arise under the act, and the host of complicated provisions which are written into the statute in order to make it halfway palatable. Furthermore, the base period soon gets out of date, especially if the emergency lasts more than a few years. But however crude and capricious base-period earnings may be, they are probably the best available measure of normal profits and must be used if we levy an excess profits tax.[5] Therefore, if we must have an excess profits tax based on average earnings in the base period, we can and should use it only to the extent it is absolutely necessary.

Reducing the coverage of the excess profits tax and increasing the rate of the corporation income tax would also result in a lower marginal rate for those corporations previously but no longer subject to the excess profits tax. To yield a given amount of revenue, a higher marginal rate is needed with an excess profits tax than with a corporation income tax because the excess profits tax does not reach all corporations or all of each corporation's profits. Since the high marginal rate of the excess profits tax has a depressive effect on incentives and is conducive to inflationary waste, reducing the marginal rate is one of the main advantages of our proposal.

Having stated the affirmative case for our proposal, we may now consider anticipated arguments in opposition. It could be argued that the proposed method of computing the excess profits tax would be unsatisfactory because of its indefiniteness as to the amount of the excess profits tax liability. Normal profits for the current year could not be computed until after the average earnings of all corporations had been computed, but this would not be a serious problem because business forecasters could make reasonably accurate estimates of current year average earnings of all corporations. Furthermore, any indefiniteness which might result would actually be advantageous because it would reduce the depressive effects of the excess profits tax on incentives and efficiency. If the individual corporation could not accurately predict its excess profits credit for the current year until after all corporations had earned their

[4] Reducing the area of coverage of the excess profits tax would also reduce the anomalous benefit which it unavoidably gives to corporations that can borrow money at low rates of interest. It has been pointed out by various writers that since invested capital may be increased by means of borrowing, the resulting increase in the excess profits credit may cause a tax saving in excess of the interest cost. Present operation of existing provisions of the law creates too many such absurdities.

[5] Many examples could be given of the freakish results obtained by using base-period average earnings, but two will be sufficient. If Corporation A had base-period earnings of 5, 10, 15, and 20 in the years 1946-1949 respectively, and Corporation B earned 20, 15, 10, and 5 in the same years, their excess profits credits would be identical, but current year earnings of 25 would certainly be more indicative of excess profits if earned by Corporation B than by Corporation A. If Corporation C earned 20 in each of the years 1946-1949 and Corporation D earned 20, 30, 10, and 20 in the same years, average earnings in the three best years of the base period would give Corporation C a credit of 20 and Corporation D a credit of 23⅓, but D's irregular earnings might very well have been the result of accounting practices or any number of unusual circumstances.

profits, and since the individual corporation's profits could increase at the same rate as the average earnings of all corporations and still have no increase in excess profits, there would be an incentive to earn the highest possible profits. Each corporation would be like a runner who is leading a race and who must keep ahead of the other runners in order to win; since he doesn't know how fast the others will run, he must run as fast as possible even though he should thereby win by a substantial distance.

Another possible criticism of the proposal would be that increasing the yield of the corporation income tax and reducing the yield of the excess profits tax would result in increased shifting of the taxes on corporate profits because the corporation income tax is easier to shift. But the incidence of the corporation income tax is predominately believed to be on the stockholders. Furthermore, the increased use of the corporation income tax would be mainly a change only in the form of tax because the effect on the distribution of the total tax load would not be very substantial, and it is doubtful that merely changing the form of the tax would cause increased shifting.

It could also be argued that because the proposed excess profits tax would utilize invested capital in its measure of normal profits, it would inherit the difficult problem of measuring invested capital. Although invested capital would have to be computed, these difficult measurement problems would be largely avoided. The proposed excess profits credit would be based on each corporation's own base-period average earnings as a percentage of net worth, thereby allowing for the differences in risk and necessary return and for the return from intangible assets such as goodwill, patent rights, superior management, etc. Also, the valuation problems arising out of use of original cost in a period of inflation would be largely solved because excess profits would be computed on the basis of current-year earnings, expressed as a percentage of net worth, in relation to base-period earnings, expressed as a percentage of net worth, with net worth measured the same way in both the base period and the current year.

Finally, it could be argued that the increase in the corporation income tax would be at the expense of those corporations which presently pay no excess profits tax and those with less than average increases in profits over their base-period earnings. It is true that use of index numbers naturally results in some corporations having less than average increases and others having greater than average increases in earnings.[6] However, many of the corporations with less than average gains still earn very high profits and should not be a cause of alarm. Special relief could be provided for certain categories of corporations such as regulated public utili-

[6] Using either weighted or unweighted averages in computing the index numbers, it is not necessary that half of the corporations have greater than average increases in earnings and half of the corporations have less than average increases in earnings; one corporation with a 20 per cent increase in earnings might be balanced by two corporations with 10 per cent decreases in earnings. If weighted averages were used, half of the increase in total profits would be above average and half would be below average; if unweighted averages were used, more than half of the increase in total profits would be above average if, as in the case of our sample of 115 corporations, the larger corporations were most favorably affected by the emergency.

ties that are known to suffer rather than gain from inflation and, if thought necessary, further relief could be extended to corporations with decreased *actual* earnings during the emergency and could take the form of a decrease in the corporation income tax rate for these corporations. The reduction in revenue could be made up by increasing the rate of the excess profits tax or, preferably, the rate of the corporation income tax. Also, any increases in the corporation income tax could be confined to the surtax where it would not reach smaller corporations. But, in order to avoid undue complication, relief should be granted only where absolutely necessary.

Conclusion

The excess profits tax is generally recognized as one of the crudest instruments in our considerable kit of tax tools. It is justified by the fact that in an inflationary period the forces of competition apparently do not adequately control profits, and this sort of condition does not seem likely to disappear in the near future. But it is possible to recapture most excess profits by more refined instruments. By confining the excess profits tax to the area where it could accomplish a unique purpose, the proposed method of taxing corporate profits during a war or similar emergency would be a clear gain for decency in the tax system.

"PAY-AS-YOU-GO" WITHHOLDING UNDER STATE AND LOCAL INCOME TAX LAWS

DAVID R. ROBERTS *

IN A PERIOD when inflation has rapidly pushed up the individual's gross income and his state income tax bill, we might expect to find widespread use of withholding. The facts are to the contrary. Only four states or territories and a few cities use mandatory [1] withholding from residents. Apparently this is the case although, as this study reveals, there are now relatively few legal obstacles to "pay-as-you-go" withholding.

I am going to consider here the statutes, constitutional provisions, regulations, court decisions, and administrative rulings (such as they are) from those states or territories that have withholding provisions in one form or another. Particular emphasis will be given to the recent Alaskan pay-as-you-go withholding law which appears to be the simplest and most effective income tax collection method yet devised. Some reference will be made to litigation involving municipal withholding taxes. I will pass over any extended discussion of economic or administrative experience,[2] except for a few comments on problems as these have been developed in the cases, regulations, or rulings. There will be some attempt to consider statute draftsmanship.

An illustration of our problem is the experience of the tax man who is preparing a decedent's final income tax return, only to discover that no state returns have ever been filed by the decedent in his lifetime. Or, consider the occasional experience with a once low-income client who is in the office on other business and suddenly announces, "You know, I've never filed a state income tax return. What will happen to me? Should I begin now?" We do not print our practitioner's replies for fear of embarrassing him.

Perhaps these are isolated cases; perhaps they are not. It is reasonable to suppose that at the state level, as in the federal experience,[3] the number of new taxpayers is constantly increasing as exemptions and personal credits become fairly meaningless. In absence of withholding or relatively high compliance levels in furnishing information returns, plus vigorous enforcement, the chances for evasion by nonfiling seem good. The incentive for nonreporting increases as the average lump sum tax bill reaches

* The author is associated with the law firm of Sullivan, Stringer, Donnelly and Sharood in St. Paul, Minnesota.

[1] Alaska, Hawaii, Oregon, and Vermont.

[2] The advantages have been ably presented by W. W. Collier, "Oregon's Withholding Tax." 3 *National Tax Journal* 193 (1950), and J. K. Lasser, "Income Tax Simplification in Vermont," 1 *National Tax Journal* 62, 66 (1948).

[3] Thus, under the present law, between ten and fifteen million additional withholding tax returns are expected for 1953, resulting from the increase in number of wage earners. C. W. Stowe, "Problems in Federal Taxation," 3d *Institute on Oil & Gas Law*, p. 383 (Bender, 1952).

a substantial figure,[4] and as shortages of auditing and enforcement personnel increase.

These examples also raise fascinating by-questions: Do better results come from diversified and many taxes, or from careful and scientific collection of a few basic taxes? Has the income tax declined in relative popularity as a tax because it is not "self-collecting" by comparison to the sales tax? Does the taxpayer prefer to have his obligations paid while he earns and to have the tax deducted before it can be spent, or to write one or two checks for a lump-sum tax? Is there a psychological advantage in having large, single payments in terms of taxpayer interest in government efficiency, budgets, and expenditure? At this writing, we know little or nothing of the kind of thinking which tips the scale in favor of one form of tax payment or another. But the fact exists that federal pay-as-you-go withholding has been in effect and generally accepted during taxable years since 1940, and the mechanics of this collection are pretty generally established and understood by employers and taxpayers alike.

Three Kinds of State Withholding

Roughly speaking, the states having withholding provisions in their statutes can be divided into three groups: (1) The true pay-as-you-go withholding, which utilizes the employer or creditor as the withholding agent.[5] (2) The "standby" or optional withholding in which the tax administrators are authorized to direct withholding at their option by individual notice or by regulation. These in turn are subdivided into those states (a) which limit the standby power to withholding from nonresident taxpayers,[6] or (b) which permit standby withholding as to resident and nonresident taxpayers alike.[7] (3) Mandatory withholding from payments to nonresident individuals or corporations.[8]

Significantly, none of the administrative authorities empowered to use withholding as to residents under standby laws have elected by regulation to make them applicable generally to residents on a mandatory basis. California's Tax Franchise Board has by regulation exercised the option on a mandatory basis as to nonresidents.[9] Likewise, Maryland's comptroller, who was granted an optional standby statute as to nonresidents, has required mandatory withholding from payments made to nonresident individuals.[10]

An express direction from the legislature to establish a mandatory withholding plan probably is necessary before even the most enterprising tax administrator would adopt mandatory with-

[4] The national average per capita revenues from state taxes for the fiscal year ending June 30, 1951 were $103.52. *Saint Paul Dispatch*, July 11, 1952, p. 3, quoting U. S. Department of Commerce and Census Bureau.

[5] Alaska (Laws, 1949, Ch. 115, Sec. 8); Hawaii Revised Laws 1935, Ch. IV, Appendix Sec. 4, as amended; Oregon (Compiled Laws Annotated & Suppl., Ch. 110, Sec. 110-1620a); Vermont (Statutes, Sec. 945).

[6] District of Columbia (47 USCA Sec. 1586(g)); Kentucky (Revised Statutes, Sec. 141.020); Maryland (Code Annotated, Art. 81, Sec. 250).

[7] Arkansas (Statutes, 1947, Title 84, Ch. 20, Sec. 84-2026); California (Revenue and Taxation Code Sec. 18805, but made applicable to nonresidents only by regulation); Louisiana (Revised Statutes Sec. 47:164).

[8] Colorado (Colo. Statutes Annotated Ch. 84.1, Sec. 28 as amended by Laws 1949, Ch. 171); Iowa (Code, Sec. 422.16); Kentucky (Revised Statutes, Sec. 141.020); New York (Tax Law, Ch. 60, Sec. 366); Wisconsin (as to dividends only to December 31, 1951. Repealed by Ch. 394, Laws 1951).

[9] California Income Tax Regulations, Sec. 18805-18810(a).

[10] Maryland Income Tax Regulation No. 1.

holding as to its own residents. Due to statutory and common-law obligations of employers to pay over the entire earnings to his employees, such regulations could encounter serious trouble in the courts if not supported by an unequivocal legislative intent.

Constitutional Provisions Slight Obstacle

The pay-as-you-go form of withholding has been sustained under a rather typical uniformity provision [11] contained in the Organic Act of Alaska. In a recent case, *Alaska Steamship Co. v. Mullaney*,[12] it was held that the uniformity clause was intended to apply only to a property tax, and therefore the federal Constitution's equal protection clause did not apply to prevent collection of the tax from a seaman's wages. This interpretation of a uniformity clause as relating primarily to the property tax rather than to an income tax is consistent with the rulings in the majority of states where the courts do not treat an income tax as a form of property tax.[13]

But in those states which require that an income tax be " proportional," or where the courts do not limit the uniformity clause to the property tax, the result could be different [14] in the absence of specific constitutional amendment authorizing the income tax and withholding provisions.

A state's equal privileges and immunities clause appears to present no obstacle to withholding provisions reaching nonresidents only, although the point has not been squarely litigated.[15]

In the absence of a provision in the New York constitution authorizing an income tax, withholding was sustained as to nonresidents in the leading case of *Travis v. Yale & Towne Mfg. Co.*[16] The opinion of the United States Supreme Court in that case disposes of most of the constitutional and practical objections which are voiced against withholding from wages. Vermont has pay-as-you-go withholding in the absence of constitutional provisions except one requiring benefit to the community; [17] but the Vermont provisions have not been tested in the courts in reported decisions.

Three principal contentions have commonly been made and rejected under the federal Constitution: (1) That withholding violates the contract

[11] Under the Organic Act of Alaska (48 USCA Sec. 78) ". . . all taxes shall be uniform upon the same class of subjects and shall be levied and collected under general laws and the assessments shall be according to the full and true value thereof. . . ."

[12] 84 F. Supp. 561 (D. C. Alaska 1949), aff'd 180 F. (2d) 805 (CA-9, 1950).

[13] *Reynolds Metal Co. v. Martin*, 269 Ky. 378, 107 S. W. (2d) 251 (1937); appeal dismissed 302 U. S. 646, 58 S. Ct. 146 (discusses withholding from nonresidents); *cf Re Opinion of the Justices*, 133 Me. 525, 178 A. 621 (1935); *State ex rel. Atwood v. Johnson*, 170 Wis. 218, 175 N. W. 589 (1919); *see* annotations 7 ALR 1617; 70 ALR 449 (1931); 71 ALR 256 (1932); 97 ALR (1934).

[14] *E.g., In re Opinion of the Justices*, 266 Mass. 583, 165 N.E. 900 (1929); *Id.*, 220 Mass. 613, 108 N.E. 570 (1915); *Conner v. State*, 82 N.H. 126, 130 A. 357 (1925).

[15] Cf., Iowa Constitution Art. I, Sec. 6, construed in *Vilas v. Iowa State Board of Assessment and Review*, 223 Iowa 604, 273 N. W. 338 (1937), appeal dismissed 302 U. S. 637, 58 S. Ct. 38.

[16] 252 U. S. 60, 40 S. Ct. 228, 64 L. Ed. 460 (1919) aff'g 262 Fed. 576 (D. C., N. D., N. Y.). The same result was reached in Oregon in absence of express constitutional grounds when operation of withholding was made contingent upon whether a sales tax was in effect. *Marr v. Fisher*, 182 Or. 383, 187 P.(2d) 966 (1947).

[17] Vermont Constitution, Art. 9th.

clause Art. I, Sec. 10 by impairing the contract between employer and employee [18] or corporation and stockholder.[19] (2) That withholding violates the due process clause of the 14th Amendment.[20] (3) That nonresidents are denied equal protection of laws under the 14th Amendment [21] by withholding from wages or from dividend payments, or from regular trust payments. It has been contended unsuccessfully that withholding out of dividends from earnings arising within a state to a foreign corporation unduly burdened interstate commerce.[22]

The most recent case sustaining withholding of wages from residents and nonresidents alike is *Alaska Steamship Line v. Mullaney*.[23] In that case, the Alaska withholding statute provided that every employer who makes a payment of wages or salaries shall deduct a tax in the amount of 10 per cent *of the federal income tax deducted*,[24] and remit the same to the tax commissioner. The entire statute and withholding provisions were attacked by an employer of seamen in interstate commerce on the grounds of improper delegation of legislative power under the due process clause, under the federal due process, equal protection clause, and under the Alaska Organic Act uniformity clause. The court sustained the act in its entirety and held that even if the legislature of Alaska adopted the federal tax laws by reference, no unconstitutional delegation of legislative power occurred. The question of whether an unconstitutional delegation occurred because of inclusion of future amendments of the federal withholding provisions in the Alaska act was not squarely presented, since no such amendment had yet occurred. Yet the court said:

> We think it is far from clear that any invalid delegation is attempted. There are of course many cases which have held attempts by a legislative body to incorporate provisions into its enactments by reference to future acts or other legislatures to be invalid. But where it can be said that the attempt to make the local law conform to future changes elsewhere is not a mere labor-saving device for legislators, but is undertaken in order to obtain uniformity which is itself an important object of the proposed legislative scheme, there are a number of precedents for approval of this sort of thing. . . .[25]

The court refers to reciprocal and retaliatory legislation, the 80 per cent

[18] *Travis v. Yale & Towne Mfg. Co.*, 252 U. S. 60, 40 S. Ct. 228, 64 L. Ed. 460 (1919). *Cf.*, *Chanler v. Kelsey*, 205 U. S. 466, 27 S. Ct. 550, 51 L. Ed. 882 (1907); *Royal Mineral Assoc. v. Lord*, 13 F.(2d) 227, 229 (D. C. Minn., 1926).

[19] *State ex rel. Froedtert Malting & Grain Co., Inc. v. Tax Commissioner*, 221 Wis. 225, 265 N. W. 672 (1936). But *cf.*, *Wisconsin v. J. C. Penney Co.*, 311 U. S. 435, 61 S. Ct. 246 (1940) discussed *infra*.

[20] *Travis v. Yale & Towne Mfg. Co.*, 252 U. S. 60, 40 S. Ct. 228, 64 L. Ed. 460 (1919); *Reynolds Metal Co. v. Martin*, 269 Ky. 378, 107 S. W. (2d) 251 (1936), appeal dismissed 302 U. S. 648, 58 S. Ct. 146 (1937); *Alaska Steamship Line v. Mullaney*, 84 F. Supp. 561 (D. C. Alaska 1949), aff'd 180 F. (2d) 805 (CA-9, 1950).

[21] *Alaska Steamship Line v. Mullaney*, 84 F. Supp. 561 (D. C. Alaska 1949). aff'd 180 F. (2d) 805 (CA-9, 1950); *Travis v. Yale & Towne Mfg. Co., supra; State ex rel. Wisconsin Trust Co. v. Widule*, 164 Wis. 56, 159 N. W. 630 (1916).

[22] *Wisconsin v. Minnesota Mining & Manufacturing Co.*, 311 U. S. 452, 61 S. Ct. 253 (1940).

[23] 84 F. Supp. 561 (D. C. Alaska 1949), aff'd 180 F. (2d) 805 (CA-9, 1950).

[24] Laws of Alaska, Ch. 115, Sec. 8.

[25] 180 F. (2d) 805, 816 (1950). See also Starr, "Reciprocal and Retaliatory Legislation," 21 *Minnesota Law Review* 371 (1937); Kessell, 87 *Journal of Accountancy* 293, 296 (1949); Mermain, 57 *Yale Law Journal* 1, 18 (1947).

credit provisions of the federal estate tax, and the Federal Conformity Act.

This is a sweeping decision, and it opens the door for a convenient new method of state withholding which can keep abreast of changes in the federal law and use federal returns with a minimum of inconvenience. The opinion of the Ninth Circuit makes no distinction as to the power to levy and collect such a tax between a territory and a state, treating the Alaska Organic Act as equivalent to a state constitution. The same standards of due process and equal protection of the laws were applied to incomes received outside Alaska as would be applied to a state, and the statute was found to have delegated to the tax commissioner an adequate authority to provide different apportionment if the statutory formula produced inequitable results.

In situations where earnings or periodic income arise within the taxing state, but withholding is directed as to payments made to nonresidents, the Wisconsin experience with its dividends withholding tax is especially instructive. Wisconsin in 1935 imposed a 2½ per cent withholding tax on dividends paid to residents and nonresidents alike by resident or nonresident corporations doing business in Wisconsin. This was attacked unsuccessfully by a Wisconsin corporation doing business in Minnesota and Wisconsin in *State ex rel Froedtert Malting and Grain Co., Inc. v. Tax Commission*,[26] and by foreign corporations doing business in Wisconsin in *Wisconsin v. J. C. Penney Co.*,[27] *Wisconsin v. F. W. Woolworth Co.*,[28] and *Wisconsin v. Minnesota Mining & Manufacturing Co.*[29] The Wisconsin Supreme Court, in the last three cases cited, found the withholding tax unconstitutional as a privilege tax, the acts pertaining to which were beyond its borders. The Supreme Court of the United States, on appeal by the State of Wisconsin, held that the statute was valid and reversed for further proceedings as to the manner of application of the tax in determining which business was within Wisconsin. The *Penney* decision emphasizes the state's power to tax by means of an income tax which reaches the substantial privilege of carrying on business within the state. Mr. Justice Frankfurter said: [30]

> . . . The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. . . .[31]

A logical extension of these decisions into the grey area involving foreign corporations who are not licensed to do business in the state but are present by means of systematic and continuous

[26] 221 Wis. 225, 265 N. W. 672, 104 A. L. R. 1478 (1936) sustaining the constitutionality of Wisconsin Laws 1935, Ch. 505, Sec. 3.

[27] 311 U. S. 435, 61 S. Ct. 246 (1940) reversing 233 Wis. 286, 289 N. W. 677 (1939).

[28] 311 U. S. 622, 61 S. Ct. 444 (1940) reversing 233 Wis. 305, 289 N. W. 685 (1939).

[29] 311 U. S. 452, 61 S. Ct. 253 (1940) reversing 233 Wis. 306, 289 N. W. 686 (1939). Two later unsuccessful appeals were also made against the Wisconsin tax: *International Harvester v. Wisconsin Dept. of Taxation*, 322 U. S. 435, 64 S. Ct. 1060 (1944) (due process clause); *Minnesota Mining & Manufacturing Co. v. Wisconsin Dept. of Taxation*, 322 U. S. 425, 64 S. Ct. 1060 (1944).

[30] 311 U. S. 435 at 445 (1940).

[31] Citing *Equitable Life Society v. Pennsylvania*, 238 U. S. 143; *Maxwell v. Bugbee*, 250 U. S. 525; *Compania de Tabacos v. Collector*, 275 U. S. 87, 98; *New York ex rel. Cohn v. Graves*, 300 U. S. 308; *Atlantic & Pacific Tea Co. v. Grosjean*, 301 U. S. 412; *Atlantic Refining Co. v. Virginia*, 302 U. S. 22; *Curry v. McCanless*, 307 U. S. 357.

local activities can be based upon *International Shoe Co. v. State of Washington,*[32] where the Supreme Court held that such activities were sufficient to give Washington jurisdiction to compel payments under the state unemployment insurance act.[33]

In 1951 the Wisconsin legislature dropped the special dividends withholding tax, effective January 1, 1952,[34] treating it within a special rule that persons receiving 50 per cent or more of their taxable income from sources within the state must pay a tax on such dividends as ordinary income. Whether this resulted from administrative difficulties in collecting the tax or was legislative disapproval of dividends withholding is not apparent; at least it was a costly tax in terms of litigation produced.

Before leaving the constitutional questions, it should be noted that a number of Ohio municipal income tax withholding provisions have been sustained against the objection that the state had occupied the field or had the exclusive power to tax.[35] The power of Pennsylvania cities to impose a wage tax collected at the source, and in particular the City of Philadelphia provisions, was considered in *Philadelphia v. Westinghouse Electric Manufacturing Co.*[36] where the court thought the power of the city to levy the tax, including withholding provisions, had already been litigated,[37] and held that the power to collect at the source was an incidental power. The place where the payroll was located and the fact that part of the services might be performed within and part without the city were immaterial so long as the employer was actually present and doing business in the city, employing resident persons subject to the tax. The case is a rather complete discussion of the problems a large manufacturer with several plants encounters in collecting withholding taxes. In Kentucky, the Louisville city withholding taxes on individuals have been sustained and the tax imposed on federal employees.[38]

Federal-State Relations

The federal government has proved to be the stumbling block to uniform withholding of state and local income taxes. The exact legal grounds for the

[32] 326 U. S. 310, 66 S. Ct. 154 (1945).

[33] See Roeskin, "Recent State Tax Trends," 30 *Taxes—The Tax Magazine,* 9, 15 (1952); *West Publishing Co. v. McColgan,* 166 P. (2d) 861 (1946) aff'd 328 U. S. 823, 66 S. Ct. 1378 (1946), citing *International Shoe Co. v. Washington, supra,* and other cases.

[34] Wisconsin Laws, 1951, Ch. 394.

[35] *Angell v. City of Toledo,* 153 Ohio State 179 (1950) (relying in part upon *Wisconsin v. J. C. Penney Co.,* 311 U. S. 435, and holding Ohio had not preempted the field under its constitution); *Humphrey v. Henderson,* 58 Abs. 140 (1950, Ohio Ct. of Appeals) (Youngstown ordinance requiring withholding of tax from wage earners employed within the city was not any more discriminatory than like federal laws); *City of Springfield v. Krichbaum,* (P-H Ohio Tax Surv., ¶ 71,032 Ohio Ct. of Appeals, 1950) and *City of Springfield v. Kurtz* (P-H Ohio ¶ 71,034, Ohio Ct. of Appeals 1951). (No discrimination nor arbitrary classification arose because residents were taxed on wages earned outside the city while income from intangible property was not reached.)

[36] 55 D & C (Pa.) 343 (1946).

[37] *Butcher v. Philadelphia,* 333 Pa. 497, 6 A. (2d) 298 (1938). It should be observed that case held invalid only the part of the city law exempting domestics, farm labor and farmers selling their own products, but sustained the rest of the law. The case is silent about the withholding provisions of the law.

[38] *City of Louisville v. Sebree,* 308 Ky. 420, 214 S. W. (2d) 248 (1948); *Cook, et al. v. Commissioner,* 312 Ky. 1, 226 S. W. (2d) 328 (1950) (employees of federal government not immune).

Comptroller General's rulings are not clear, nor are they satisfactorily supported by case law. The Comptroller General has consistently denied that the states have constitutional power to require federal agencies to withhold the state tax on payments made to federal employees.[39] In Decision B-72,432, 27 Dec. Compt-Gen. 372, the opinion stated in regard to the Oregon withholding tax law was as follows:

> In view of the well settled constitutional principle which precludes the regulation or control by a state, or political subdivision thereof, of the United States in the exercise of its governmental functions (see *Mayo et al. v. United States*, 319 U.S. 441; *Johnson v. Maryland*, 254 U.S. 51; *Ohio v. Thomas*, 173 U.S. 276), and since it is obvious that the effect of the provisions of the Oregon tax law here involved so far as the matter of withholding and payment by the Federal government of the tax in question is concerned, is such as to impose a direct burden upon the United States, it must be concluded that the withholding feature of the Oregon income tax law is not for application in the case of payments of salary or wages due to Federal employees. Consequently, payment should be made of the salary or wages due to employees of your department without the deduction of an amount representing the Oregon income tax.

The same court decisions and the above quotation were also relied upon in later declaring that federal agencies located in Louisville should not deduct the municipal income tax (28 Dec. Compt.-Gen. 101 (1948)). However, the Supreme Court of Kentucky did not agree, and in *Cook v. Commissioner of Sinking Fund of Louisville*,[40] in 1950, held that the ordinance of Louisville, including the withholding provisions, applies to employees of the United States. That court decided properly that the doctrine of intergovernmental immunities had been repudiated by the Supreme Court of the United States in three leading decisions[41] decided since *Johnson v. Maryland*, relied upon by the Comptroller General of the United States.

It is difficult to understand how the Comptroller General derives any support whatsoever from *Mayo et al. v. United States*, cited in the Comptroller General's opinion quoted above. That case did not involve taxation of employees. The question was whether the State of Florida could exact an inspection fee on fertilizer owned by the United States and shipped into Florida under the Soil Conservation and Domestic Allotment Act and for distribution under the National Soil Conservation program. The Supreme Court expressly considered the measure a licensing measure. The Supreme Court noted:

> . . . There are matters of local concern within the scope of federal power which in the silence of Congress may be regulated in such manner as does not impair national uniformity. There are federal activities which *in the absence of specific Congressional consent* may be affected *by state regulation*. *Graves v. New York ex rel. O'Keefe*, supra, upon which appellants rely so strongly, *is in this latter group*. . . . We are not dealing as in *Graves v. New York ex rel. O'Keefe*, supra, with a tax upon the salary of an employee. . . . (Italics added.)[42]

[39] Op. Comptroller General to U. S. Attorney General, 27 Dec. Compt. Gen. 372 (Jan. 6, 1948); Op. Comptroller General to the Secretary of the Treasury, 28 Dec. Compt. Gen. 101 (Sept. 17, 1948). See U. S. Treasury Dept. Release S-2779 (Aug. 13, 1951) (stating that Congress will be required to act before the federal government will start to withhold for states).

[40] 312 Ky. 1, 226 S. W. (2d) 328 (1950).

[41] *Helvering v. Mountain Producers Corp.*, 303 U. S. 376, 58 S. Ct. 623; *Helvering v. Gerhardt*, 304 U. S. 405, 58 S. Ct. 969; *Graves v. New York*, 306 U. S. 466, 59 S. Ct. 595, 120 ALR 1466.

[42] 319 U. S. 441, 446-447, 63 S. Ct. 1137, 1140 (1943).

The *O'Keefe case*[43] held that New York could constitutionally levy an income tax on the employee of the Home Owners Loan Corporation, a federal agency, and said that no tangible or certain economic burden was placed on the United States as would justify a court declaring the employee clothed with immunity. It should be noticed that at the time the *O'Keefe case* was decided, New York had on the statute books (and still has) a withholding tax from wages of nonresidents of New York who work in New York. This provision had long been sustained by the Supreme Court of the United States.[44] One wonders whether federal agencies in New York are withholding an income tax paid to their employees who happen to be residents of New Jersey or Connecticut?

Due to the interest of Oregon,[45] Hawaii,[46] Vermont,[47] and the National Tax Association,[48] two bills[49] were introduced into the 82d Congress giving authority to the Secretary of Treasury to provide for withholding by the federal government in cases where an agreement for such withholding is executed between the Secretary of the Treasury and a proper official of the state. These bills, in an amended form, became law on approval of the President July 17, 1952, as Public Law 587-82d Congress, Ch. 940-2d Session.[50] The enactment removes a troublesome impediment to fair and uniform collection of income taxes by withholding, although as a matter of law it seems likely the federal government could cooperate without the enactment of such a statute by Congress.

One other problem in federal-state relations remains to be commented upon. It is a problem which now can be met by careful draftsmanship of a newly enacted state statute. In *American Hawaiian Steamship Co. v. Fisher*,[51] a Federal District Court in Oregon held that where a federal statute prohibited restraint of the wages of seamen engaged in interstate commerce, Oregon could not constitutionally withhold from a seaman's wage since Congress intended to regulate the field and to secure uniformity. Subsequently, Oregon amended its law to exempt "wages of seamen which are exempt from garnishment, attachment or judgment under Sections 596, 597, 598, and 601 of Title 46 of the United States Code."[52] This problem, essentially involving the treatment of transient workers, can be provided for in the original enactment of a withholding provision, as will be noted in the drafting pointers considered in

43 306 U. S. 466, 59 S. Ct. 595 (1939).

44 *Travis v. Yale & Towne Mfg. Co.*, 252 U. S. 60, 40 S. Ct. 228 (1919).

45 See Collier, 3 *National Tax Journal* 193, 205 (1950).

46 See letter, Watonabe, 30 *Taxes—The Tax Magazine* 317 (April, 1952); H. R. 5224 was introduced by Delegate Farrington of Hawaii.

47 H. R. 5157 which was identical to H. R. 5224 was introduced by Rep. Prouty of Vermont.

48 See *Proceedings*, National Tax Association, 1951, pp. 25-26, 388-389, 449, submitting and adopting a resolution to Congress requesting legislation to permit departments and agencies of the federal government to withhold from compensation of their employees.

49 H. R. 5157 and H. R. 5224. H. R. 5157 was reported favorably out of the Ways and Means Committee and passed the Senate as an addition to S. 1999.

50 The text of P. L. 587 is set out in Appendix A to this article at page 347, *infra*.

51 (Unreported) See P-H Oregon Tax Service, ¶ 55, 133, 35; CCH Oregon Tax Service, pp. 16-817.50. (Decided May 18, 1948.)

52 Oregon Laws, 1949, Ch. 410, Sec. 6.

the last section of this article. The problem will arise more frequently as other kinds of organized transient workers receive protected or preferred treatment under federal law.

The Alaska Withholding Tax—A Fresh Approach

Hawaii, Oregon, and Vermont have added their withholding provisions to already complex existing income tax laws, none of which achieve uniformity with the federal law. Complete and detailed annual returns are still required and must be audited in the case of persons subject to withholding as well as those not so subject to current collection of the tax. The refund procedure is still necessary and the Oregon experience indicates requests for refund do not come in for about $600,000 of about $12,500,000 collected.[53] Vermont in 1947 adopted the first attempt to tie in the federal income tax law with the state tax by using the same net income figure as the federal return except as to gains and losses and certain exempt income.[54]

By comparison, the new Alaska law seems a complete integration of the Federal Internal Revenue Code and simplicity itself. The *tax* on individuals and corporations is measured as a flat 10 per cent of the federal tax due and payable without deduction for Alaska taxes. Withholding by employers is simply 10 per cent of the federal tax withheld.[55] The Alaska return is a simple, one side of one page affair showing the name of the employer, amount withheld, the amount of exemptions claimed on the federal return, the total amount of deductions claimed on the federal return, the federal tax payable, and a figure of 10 per cent of the federal tax which is the Alaska tax.[56] The form is simpler than a federal short form 1040-A. Special provisions are made for allocation on returns used by employees engaged in interstate commerce.[57] There are no credits and no exemptions to police.[58] Withholding returns and remittances are filed quarterly by the employer on adaptations of federal form W-2 stamped to indicate their use for Alaska.[59] Information returns are required on February 15th for interest of $600 or more, dividends of $100 or more, rents or royalties of $600 or more.[60] Of course, no deduction is provided for federal taxes paid, so no problem of proof arises on this point. Treatment of capital gains and losses, being based on the federal tax, is automatic. A copy of the federal return is sufficient to establish the liability or absence thereof.[61] Adjustments in the federal liability automatically result in adjustments of the Alaska tax.[62]

The Alaskan statute and regulations meet the federal-territory problem which troubled Hawaii by exempting from withholding remuneration for

[53] See Collier, 3 *National Tax Journal* 193, 209 (1950).

[54] See Lasser, "State Income Tax Simplification in Vermont," 1 *National Tax Journal* 62 (1948).

[55] Alaska Laws 1949, Ch. 115, Sec. 5, A; Sec. 8, B.

[56] Alaska Deptax Form 600.

[57] Form 600, Schedule 1 (on reverse of Form 600).

[58] Except in cases involving allocation, Alaska Laws 1949, Ch. 115, Sec. 5, C.

[59] Alaska, Regulation K. (Deptax Form 500).

[60] Based on Federal Law which is incorporated by reference into the Alaska Statute.

[61] Alaska Laws 1949, Ch. 115, Sec. 7, C.

[62] The taxpayer is required to report any recomputation of tax or determination of deficiency on his federal income tax returns. *Id.*, Sec. 7, C.

services performed by federal employees and services performed by members of the Armed Forces.[63]

A rather novel feature is included in the income tax statute to ensure that Alaska sales profits taxes are paid. The purchaser of taxable property (real or personal held as capital assets and not for sale or business) can withhold 1 per cent of the profits in excess of $1,000 until the tax thereon has been returned or paid.[64] If he fails to so withhold or secure evidence of return or payment, the purchaser assumes a transferee liability, which goes with the acquisition of the property, for the tax due from his predecessor in title. In other words, as to transferable property, the lien of the tax attaches as a kind of transfer tax, much like a gift or death tax, but without complex exemptions and variable rate structures.[65] The fact that evidence that the transfer has been returned or the tax paid need be presented only to the purchaser to release the 1 per cent withholding eliminates paper work and trouble for administrative personnel.

Taxpayers and practitioners in states having long and detailed income tax laws patterned on the federal law will instantly understand the advantages offered by the Alaska type statute: [66] (1) Only one set of decisions and regulations need to be learned and followed. (2) Items which are income for one law are income for the other, except as to allocation by taxpayers. (3) The complex rules for deductions, capital gains and losses, and exemptions are uniform without the annoying lag between state and federal enactment. (4) Treatment of charitable contributions will be uniform and not dependent upon reciprocal statutes or locus. (5) Audits, assessments, and deficiencies need provide only one controversy instead of relitigating the same issue with state authorities under somewhat different regulations. (6) Likewise, readjustments resulting in federal refund will result in refund of the state tax.

Tax administrators should be intrigued by the Alaska statute: (1) It has been tested in the courts and sustained by two thorough and well-reasoned opinions.[67] (2) The administration involves a minimum of decision-making, regulations, or litigation since the result reached with the federal authorities controls the tax liability. (3) Audit is reduced to mathematical computation and comparison with information returns in nearly all cases except those involving allocation. (4) Struggles to secure proof of deductions or the validity of deductions are eliminated entirely. (5) Refund procedure is reduced because there is no lengthy income-exemption-deduction computation cycle to go through; one short form suffices for all except the allocation taxpayers. (6) Pressures for change in the statute or in regulations to favor certain interests now are removed to the federal arena in so far as the details of deductions, exemptions, or special classes of taxpayers are concerned. (7) The

[63] *Id.*, Sec. 8, A.

[64] Compiled Laws, Alaska, 1949, Title 48, Ch. 6, Sec. 48-6-2.

[65] *Id.*

[66] See also M. M. Kassell, "Progress Toward Achieving Uniformity in State Income Tax Administration," *Income Tax Administration: Symposium* (Tax Institute, Inc., 1949), pp. 292, 298.

[67] *Alaska Steamship Lines v. Mullaney*, 84 F. Supp. 561 (D. C. Alaska, 1949) aff'd. 180 F. (2d) 805 (CA-9, 1950).

cost of policing and collection should be reduced to a minimum since the advantages of both withholding and federal audit will be combined in a manner heretofore not available.

Employers in states which previously have had withholding should find desirable the uniform percentage and rate of withholding rather than graduated rates based on exemptions and level of income.

Employers in states not having withholding will have the following just complaints[68] in common with all withholding agents: (1) Added burden of overhead to collect the tax for the state. (2) Added personnel to handle payrolls and withholding, particularly if allocation is involved. (3) The trouble of obtaining residency and nonresidency certificates. (4) Added management problems. (5) A whole new set of forms and reports. Under the Alaskan method, however, there is the advantage that the same rules apply to both state and federal withholding since the Alaska type law incorporates the federal law and regulations by reference, and it uses interchangeable forms for uniformity. Allocation seems to be simple enough as a mathematical computation under the Alaskan regulations and return form.

One major obstacle to the adoption of the Alaska form of withholding tax in states already having income taxes will be found in the reduction of personnel necessary for administration due to fewer auditing, negotiation, and settlement functions. However, as any state tax administrator will hasten to testify, skilled auditors have been increasingly difficult to secure. Likewise, necessary stenographers and clerical personnel under the existing system either are not available or must be hired away from business or industry by higher salaries or better retirement benefits. In states where the legislatures are genuinely concerned to secure economy of collection of the maximum amounts of taxes already on the statute books, the Alaskan withholding method should be a subject of objective research and analysis in terms of: (1) Reduction in cost of collection; (2) Increase in over-all collections; (3) Simplicity of enforcement; and (4) Reduction of wasted taxpayer time in calculation of tax and making out returns. Personnel now used for auditing or negotiation can be shifted advantageously to collection of other taxes and to front-line enforcement and evasion investigative activities where they are needed.

Some Drafting Notes

Certain provisions commonly appear in withholding statutes, or are placed there by later amendment, with sufficient frequency to raise an inference that administrative or legal difficulties will be encountered in their absence. These provisions include a clause protecting the employer from suits due to nonpayment of moneys deducted from wages or salaries in compliance with the withholding law.[69] Vermont has a rather unusual provision along this line which announces that the employer:

> . . . is indemnified against the claims and demands of any individual corporation or

[68] See also Homuth, "The Taxpayer Angle on Local Income Tax Administration," *Income Tax Administration: Symposium* (Tax Institute, Inc. 1949), pp. 329, 333.

[69] Oregon Comp. Laws Annotated, Sec. 110-1620a (1).

partnership for the amount of any payments made in accordance with the provisions of this section.[70]

Questions arise under the Vermont statute as to who does the indemnification in event of liability and from what fund? Suppose the withholding is intended to be correct but is in fact erroneous, is the employer liable for penalties for failure to pay over wages, such as triple the wage as under some state wage-payment laws? Does the employer who is sued by an employee interplead the state to answer the suit? The Oregon form of statute, which was derived from the British Columbia 1938 law,[71] seems the better approach since the suit appears barred at the outset to the extent the employer can show he "intended compliance" with the tax law.[72]

The second problem has to do with farm and transient labor, either migratory farm labor or otherwise. The Alaskan approach is to exempt all employees exempted under the Federal Act, IRC Sec. 1621 or as amended. This includes all agricultural labor and domestics, as well as casual labor not in the course of the employer's trade or business.[73] Vermont likewise has the same exemptions as the federal act for all agricultural labor and certain casual labor.[74] Oregon started to collect from transient labor including all farm migratory labor, then in 1949 amended its statute to exclude wages for casual labor paid to part-time employees whose services consist only of labor in connection with planting, cultivation, or harvesting of seasonal agricultural crops.[75] But all agricultural employees were not exempted, and the interpretation of the seasonal exemption was narrowly construed to be limited to those seasonal occupations where there was a large turnover each *day*.[76] The federal, Alaska, and Vermont legislation suggest that farm wage withholding is not desirable; Oregon experience indicates considerable difficulty in administration of farm wage withholding where the statute requires it.

Alaska handles a third matter, the refund problem, by a single general statutory provision delegating the determination to the commissioner of taxation, but clearly linking the refund to the federal determination.[77] Under such a system the return is the claim for refund without further audit. If, later, added tax is shown on the federal audit, then Alaska obtains its percentage of the additional tax.[78] Oregon experimented with a minimum refund where the refund exceeded $2.00. Subsequently this minimum was reduced to $1.00 and a two-year statute of limitations for the claim for refund enacted.[79] The minimum refund provision seems very desirable, but under the Alaskan

70 Vermont Statutes, Sec. 945, III.

71 See Collier, 3 *National Tax Journal* 193, 201 (1950); British Columbia Laws 1938, Ch. 210, Sec. 23.

72 ". . . No employee shall have any right of action against his employer in respect of any moneys deducted from his wages and paid over in compliance or intended compliance with this section." Oregon, Sec. 110-1620a (1) cited above.

73 Alaska, Regulations E.

74 Vermont Statutes, Sec. 945, I.

75 Oregon Laws 1949, Ch. 410, (e).

76 Oregon Legal Dept. Abstract, O. F. 550 (May 11, 1950); O. F. 495 (Feb. 3, 1950).

77 Alaska Laws 1949, Ch. 3, Sec. 7 C, D.

78 *Id.*, Sec. 7, C.

79 Oregon Laws, 1951, Ch. 575; Oregon Compiled Laws Annotated, Sec. 110-1620a (5) (a).

type of withholding the refund period should be kept open as long as federal returns are open, whether by agreement or otherwise. None of the statutes apparently make express provision for a refund to the employer who overpays the tax, except perhaps under the Alaska law by inclusion of federal law. This is a drafting point which should be covered.

At the end of this article are tables showing a comparison of the four pay-as-you-go withholding jurisdictions for various administrative provisions and exempt employee groups under the statutes.[80]

[80] Pp. 348-350.

CONCLUSIONS

Relatively few legal obstacles prevent adoption of simple and effective withholding provisions for collection of income taxes in states using this tax as a principal source of revenue. The Alaskan form of withholding law, which levies a simple percentage of the federal income tax paid, appears particularly attractive because it retains uniformity with federal law and administration. The simplicity of the Alaskan tax suggests that the income tax now can compete economically and favorably with the sales tax as a means of raising substantial revenue for state and local governments.

APPENDIX A

Public Law 587—82d Congress
Chapter 940—2d Session
S. 1999

AN ACT

Relating to withholding, for State income tax purposes, on the compensation of Federal employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That where - -

(1) the law of any State or Territory provides for the collection of a tax by imposing upon employers generally the duty of withholding sums from the compensation of employees and making returns of such sums to the authorities of such State or Territory, and

(2) such duty to withhold is imposed generally with respect to the compensation of employees who are residents of such State or Territory,

then the Secretary of the Treasury, pursuant to regulations promulgated by the President, is authorized and directed to enter into an agreement with such State or Territory within one hundred and twenty days of the request for agreement from the proper official of such State or Territory. Such agreement shall provide that the head of such department or agency of the United States shall comply with the requirements of such law in the case of employees of such agency or department who are subject to such tax and whose regular place of Federal employment is within the State or Territory with which such agreement is entered into. No such agreement shall apply with respect to compensation for service as a member of the Armed Forces of the United States.

Sec. 2. Nothing in this Act shall be deemed to consent to the application of any provision of law which has the effect of imposing more burdensome requirements upon the United States than it imposes upon other employers, or which has the effect of subjecting the United States or any of its officers or employees to any penalty or liability by reason of the provisions of this Act.

Approved July 17, 1952.

APPENDIX B

COMPARISON OF ADMINISTRATIVE PROVISIONS OF PAY-AS-YOU-GO WITHHOLDING STATUTES

State	Minimum Income for Return—Form	Withholding Done by	Withholding Paid When by Agent	Must Federal Return Copies be Furnished	Refunds	Declaration—Information Return
Alaska	$100 or more subject to withholding. - - - One page return.	Employer. Seller.	Quarterly—March 31, June 30, September 30, December 31. As sold or as purchased. Annual reconciliation.	Yes, on request. Notice of any alteration or change in federal liability required by statute.	Return is request for refund. A return must be filed to secure refund. No minimum amount.	Declarations required. Information returns required: Dividends $100 or more Interest 600 or more Rent, royalties 600 or more Miscellaneous 600 or more
Hawaii	From $1,100 if single to $2,200 if married. Depends also on source of income whether from within Islands or not. - - - Full four page return.	Employer. Local company paying dividends to shareholders. Value of board and lodging included in tax base.	Monthly, but quarterly payments to commissioner may be permitted on 20th of April, July, October, and January. 20th of month after dividend. Annual reconciliation.	No special provision but commissioner may require special statements or records. No notice of federal change required.	Only after audit and only if the taxpayer has no unpaid installment due. Refund application must be filed within six months after end of year. No minimum amount.	Declaration not required. Information returns required: Withholding statement only.
Oregon	Single: *Net* income of $750 or more. Married: *Net* income of $1,500 or more. Every individual with *gross* income over $4,000. - - - Full three page return.	Employer, at graduated rates.	Quarterly, April 30, July 31, October 31, January 31. Annual reconciliation.	No special provision, however, the commissioner can inspect books and records or demand production of same.	Only after audit. Interest payable. Return is claim for refund and cannot be applied to later tax. Minimum refund is $1.00.	Declaration not required. Information returns required: Interest $ 250 or more Rents, royalties } 750 single; 1,500 married Dividends 100 or more Other No limit
Vermont	$500—resident. $500—from sources within state as to nonresident. - - - Full three page return.	Employer, at graduated rates.	Quarterly, April 30, July 31, October 31, January 31. Annual reconciliation.	No special provisions. Notice of alteration or change of federal liability required by statute.	Refund after computation of tax at discretion of commissioner. Interest payable. No application on later installment or tax due. No minimum amount.	Declaration required. Information returns required: Interest, Rent, Premiums, Gains, Deposits } $500 or more

Source: Prentice-Hall, *State & Local Tax Service*, Alaska, Hawaii, Oregon, and Vermont units.

APPENDIX C

Comparison of Principal and Exempt Class of Employees Under Pay-As-You-Go Withholding Statutes

State	Residents Subject	Non-residents Subject	Employees Exempt from Withholding
Alaska	All, except Group A	All, except Group B	A. *Residents:* 1. Federal employees and military forces. 2. Agricultural labor. 3. Domestic service in home, college club, local chapter house. 4. Casual labor not in course of employer's business. 5. Minister of gospel. 6. Fees to public official. 7. If less than one-half of time is wage then none deemed wage. B. *Nonresidents:* 1. Sources derived within the territory with detailed schedule for apportionment. 2. Federal employees or military.
Hawaii	All	All	Limited exclusion of occasional services. Includes U. S. and agencies, but not clearly military.
Oregon	All, except Group A	All, except Group B	A. *Residents:* 1. Active duty in military service. 2. Domestic service including college clubs or chapters of fraternity or sorority. 3. Casual labor not in course of employer's trade. 4. *Part-time* agricultural laborers. 5. Seamen except from attachment or garnishment under 46 USC Secs. 596, 597, 598. B. *Nonresidents:* 1. As above. 2. Employees of common carrier in and out of the state.
Vermont	All, except as noted in Column 4	All, except as noted in Column 4	Exemptions are the same as under federal law, the chief classes of exemptions being agricultural workers and domestic help.

Source: Prentice-Hall, *State and Local Tax Service* (State Personal Income Tax Edition) (Alaska, Oregon, Vermont, returns and official instructions). Prentice-Hall, *Hawaii Tax Service* (returns and official instructions, law).

APPENDIX D

Comparison of Personal Income Tax Revenues for State and Territorial Governments Having Pay-As-You-Go Withholding Laws

State	1946	1947	1948	1949	1950	1951	Remarks
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Alaska[a]	$........	$........	$........	$........	$4,309,156	$ [b]	(a) Includes corporate income tax. (b) Not yet reported.
Hawaii[c]	8,504,384	9,205,616	9,981,883	9,787,188	9,034,072	9,891,931	(c) Withholding tax on compensation enacted in 1935 by Hawaii.
Oregon[d]	14,486,634	19,972,380	30,863,181[d]	35,863,474	29,459,533	35,945,614	(d) Oregon enacted withholding provision in 1947 reflected in the 1948 collections.
Vermont[e]	1,601,204	1,929,956	3,112,282[e]	3,584,514	4,228,922	4,900,500	(e) Vermont enacted withholding provisions in 1947 effective in 1948 collections.

Note: None of the states indicate rate increases in the years shown.
Source: Commerce Clearing House, *Tax Systems* (1952), pp. 338, 343, 347.

THE DYNAMICS OF TAX BURDEN COMPARISONS *

ALBERT C. NEISSER †

THE ANALYSIS of the burden of taxation by income classes has been limited in the past to the study of a given tax system and its impact at a given point of time. From the pioneer work of Gerhard Colm and Helen Tarasov in 1940 and 1942 [1] to the recent analysis by Richard A. Musgrave in 1951,[2] burden studies have aimed at providing a test of the progressivity, proportionality, or regressivity of a given tax system and its component parts. The percentage of the average income paid in taxes in each income bracket was presented in sets of effective rates of tax both for specific types of taxes and for the tax system as a whole. Comparisons of effective rates of tax at different points of time yielded answers to the question of whether persons whose income before taxes fell into a certain income class, on the average, paid a higher or lower percentage of their income in taxes than persons in the same income bracket would have paid at another time and under a different tax system.

Comparisons of tax burdens of this type were static in their approach; they disregarded the fact that, due to changes in income and in prices, the same persons may not be in the same income bracket during the two periods under observation. Under relatively stable economic conditions the comparison of effective rates of tax satisfactorily demonstrated whether persons were better or worse off in terms of disposable income; in times of rapid change the comparison of effective rates will indicate whether the tax load was more equitably distributed in one period than in another, but it will not provide an adequate answer to the question of whether taxpayers are better or worse off than they were previously. As Gerhard Colm and Haskell Wald pointed out in their recent article, " We believe that in a period of rising expenditures (i.e., government expenditures) the static analysis of the type presented in the TNEC study and the Musgrave study

* EDITOR'S NOTE: To meet the space limitations of the *Journal*, this manuscript has been condensed from a much longer study presenting a more elaborate analysis and more complete tabular data. We are informed that mimeographed copies of the full study are available on request from the author (Tax Advisory Staff of the Secretary, Treasury Department, Washington, D. C.).

† The author is a member of the Tax Advisory Staff of the Secretary of the Treasury. The views expressed and the estimates made are those of the author and do not necessarily reflect opinions or estimates of the Treasury Department.

I gratefully acknowledge the friendly help of John Copeland with whom I discussed many points of procedure and whose advice in the estimation of the burden of specific excise taxes was invaluable to me. I am also indebted to Richard E. Slitor and Joseph A. Pechman for many suggestions and encouraging criticism. Needless to say, I alone should be blamed for the shortcomings of this paper.

[1] G. Colm and H. Tarasov, *Who Pays the Taxes?*, Monograph No. 3 (Washington: Temporary National Economic Committee), 1940; H. Tarasov, *Who Does Pay the Taxes?*, Supplement IV, *Social Research* (New York: New School for Social Research), 1942.

[2] R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, " Distribution of Tax Payments by Income Groups: A Case Study for 1948," *National Tax Journal*, IV (March, 1951), p. 1.

must be supplemented by a dynamic analysis which takes into consideration the rise in incomes (resulting from the defense program) and the rise in taxes."[3]

At the suggestion of Gerhard Colm, I prepared an analysis of changes in disposable income after all federal taxes since the outbreak of hostilities in Korea. This analysis, which was incorporated in the article quoted above, compared disposable income after all federal taxes of taxpayers at various levels of income in the first half of 1950 with disposable income in 1951, under the assumption that the gross income of such taxpayers increased by various hypothetical percentages.[4] In this paper the same type of analysis will be applied to income levels estimated for the calendar year 1952 and at rates under the Revenue Act of 1951.

The conventional static type of burden comparisons provides criteria for selecting the type of tax to be imposed if there is a choice between various alternative forms of taxation. In times of rising government expenditures, however, the alternatives are rather "the possible imposition of additional taxes or the impact of inflationary or noninflationary deficit financing. One of the alternatives which should be examined in such a situation is the burden that inflation imposes on various income brackets, compared with the burden that various additional taxes imposed on the same people."[5]

Since the outbreak of hostilities in Korea, defense expenditures have increased sharply, stimulating large increases in personal income and private investment. Consumer prices have also risen despite the fact that government receipts have exceeded government expenditures by a substantial margin.

The objective of the present article is to provide tentative answers to the following questions which are raised by dynamic changes in the economy and which cannot be answered by means of static burden analysis: (1) Were taxpayers on the average better or worse off in 1952 than in the first half of the calendar year 1950? (2) Were taxpayers of different family status and at different income levels better or worse off in 1952 than they were before Korea? (3) How large an increase in their gross income did taxpayers need in 1952 to obtain the same real income they had obtained before the outbreak of hostilities in Korea? And, finally, (4) to what extent were increases in incomes absorbed by increases in federal taxes and to what extent by increases in prices?

The discussion of the first three questions will be attempted on the basis of disposable income after the federal individual income tax only—federal excises and the shifted portion of corporation taxes being taken into consideration in the price adjustment. The fourth question—that of the relative weight of price increases and of tax increases in changes of real disposable income—will require an analysis of all federal taxes and their effect on the consumer price level.

[3] G. Colm and H. P. Wald, "Some Comments on Tax Burden Comparisons," *National Tax Journal*, V (March, 1952), p. 6.

[4] *Ibid.*, p. 7. The analysis took into account increased rates of federal taxes imposed under the Revenue Act of 1950, the Social Security Act Amendments of 1950, the Excess Profits Tax Act of 1950, and the further rate increases proposed by the Secretary of the Treasury in his statement before the Committee on Ways and Means, February 5, 1951. Since the computations were made before its enactment, the rates adopted in the Revenue Act of 1951 could not be taken into account.

[5] *Ibid.*, p. 4.

I. *Were Taxpayers on the Average Better off in 1952 Than Before Korea?*

The yield of the federal individual income tax is expected to increase from an annual level of $16.8 billion during the first half of the calendar year 1950 to about $29 billion during the calendar year 1952. About half of this increase is attributable to the rate increases of the Revenue Acts of 1950 and 1951, the other half to increases in income and the accompanying shifts of taxpayers into higher rate brackets. Total personal income during the period covered is estimated to increase from $216.7 billion to $270 billion, or 24.6 per cent, and income reportable on tax returns (adjusted gross income) is estimated to increase from $185 billion to $240 billion, or 29.7 per cent.[6] After deduction of the federal income tax, taxpayers are estimated to be left with $211.0 billion in 1952 as against $168.2 billion in the first half of 1950, in current prices. Income after federal income tax in constant, first-half-of-1950 prices will increase from $168.2 billion to $186.1 billion, or 10.6 per cent, if it is assumed that the price level, as measured by the Consumer Price Index of the Bureau of Labor Statistics, increased from 168.8 to 191.4, or by 13.4 per cent. On the assumption of an increase from 52 to 54 million in the number of tax returns filed, adjusted gross income for the average taxpayer is estimated to increase from $3,558 to $4,444 (24.9 per cent), and real income after income tax is estimated to increase from $3,235 to $3,446 (6.5 per cent).

To the extent that increases in federal excise taxes and in corporation taxes have been shifted to consumers in higher prices, their impact is taken into account in the price adjustment. To the extent that corporation taxes reduced dividend payments, their impact is reflected in lower levels of personal income. With the exception of the portion of increases in corporation taxes absorbed by undistributed corporate profits and of contributions to social security funds, the above estimates represent the combined effect of increases in all federal taxes and of increases in the price level on the real income of the average taxpayer. *It may be concluded that taxpayers on the average will obtain 25 per cent more adjusted gross income in 1952 than before Korea and be better off in terms of real income after federal taxes and after adjustment for price increases than they were during the first half of 1950.*

The distribution of the increases throughout the income scale is not known. Fixed income recipients are

[6] The Department of Commerce concept of personal income is not identical with the concept of adjusted gross income as defined by the tax law. Not all personal income is taxable, and not all income to be reported on tax returns is included in the definition of personal income. The estimation of adjusted gross income on the basis of given estimates of personal income requires a large number of adjustments, described in detail by Selma F. Goldsmith in her article, "Appraisal of Basic Data Available for Constructing Income Size Distributions," *Studies in Income and Wealth*, Vol. XIII (New York: National Bureau of Economic Research), 1951. Although estimates of this type contain many conjectural elements, they are considered sufficiently accurate to put into the right perspective the estimates of tax burdens by family size and income levels, based on adjusted gross income. No adjustment is made for underreporting, but income below filing requirements is excluded. The larger percentage increase in estimated adjusted gross income compared to personal income is mainly due to the large payments of tax-free special National Service Life Insurance dividends during the first half of the calendar year 1950.

concentrated in the lowest income classes and, consequently, increases in gross income in these classes may fall short of the average increase of 25 per cent. On the other hand, the most recent information available indicates that the share of labor and farm income in the total has increased in the course of the last two years. Since income from these sources accounts for the largest portion of total income in the lower and middle brackets, it would seem likely that the distribution of the increases in gross income is fairly uniform. The increase in average income, however, is the combined effect of increases in the labor force, employment of formerly unemployed members of the labor force, earnings of those employed at the same type of work due to longer hours, higher wages, or up-grading, and shifts to more remunerative types of employment. To the extent that average income per taxpayer has increased because more persons were at work, increases in the earnings of those who were steadily employed may have fallen short of the average.

The fact that, on the average, taxpayers' income has increased 25 per cent since Korea and that, on the average, they were better off in terms of real income after taxes than they had been before the outbreak of hostilities, does not mean that all taxpayers needed such an increase to be as well off during the calendar year 1952 as they were during the first half of 1950. There are significant differences between single and married taxpayers and, within these groups, among taxpayers with a different number of dependents and at different levels of gross income.

II. *Were Taxpayers of Different Family and Income Status Better or Worse off in 1952 Than Before Korea?*

A. *Impact of increases in the federal individual income tax without adjustment for price increases.* Before we discuss changes in real income after taxes, it seems appropriate to point out that the increase in federal individual income tax rates absorbed only a relatively small portion of the increases in income before tax which most taxpayers obtained. The differences in income after deducting the federal income tax since Korea are illustrated in Table 1. The figures are in current prices and not adjusted for changes in the price level. Due to the unchanged amount of personal exemptions allowed, effective rates of tax in the lower and middle income brackets under the Revenue Act of 1951 increased much less over pre-Korean rates than the increases in marginal rates would seem to indicate.[7] It is not surprising, therefore, to find that married persons with two dependents and incomes of well over $10,000 would retain more income after taxes in 1952 than before Korea, even if their adjusted gross income increased by only 5 per cent, and that single persons with no dependents and incomes within the same range would need increases of considerably less than 10 per cent to be left with the same income after taxes as in early 1950. For instance, a married person with two dependents who earned $3,000 before Korea, and whose income increased by 5 per cent to $3,150, paid $54 under the Revenue Act of 1948—leaving him with an income after taxes

[7] The first bracket starting rate increased from 16.6 per cent to 22.2 per cent.

of $2,946 before Korea. The same person will have to pay $102 of tax under the present law on his assumed 1952 adjusted gross income of $3,150. His income after taxes will amount to $3,048 or 3.5 per cent more than before Korea. If he were single and had no dependents, his income after taxes would decrease by $1, or less than one-tenth of 1 per cent.

B. *Combined impact of increases in the federal individual income tax and in prices since Korea.* An appraisal of the change in tax burdens since Korea would not be complete if incomes after taxes were measured in terms of current dollars without accounting for changes in the price level. Price increases affect the purchasing power of income after taxes to the extent that it is currently spent, and the value of past and current savings are affected to the extent that they are held in the form of liquid assets and spent before prices return to their previous level. The price adjustment made in this study is based on income after taxes, regardless of the savings ratio. No attempt is made to integrate the impact of price increases on the value of liquid assets and other

TABLE 1

INCREASES OR DECREASES IN INCOME AFTER FEDERAL INDIVIDUAL INCOME TAX FOR VARIOUS HYPOTHETICAL INCREASES IN INCOME BEFORE TAX SINCE KOREA IN CURRENT PRICES

(Taking into Account the Increased Federal Individual Income Tax Rates Applicable to 1952 Incomes)

Per Cent Change in Adjusted Gross Income Since Korea	Adjusted Gross Income Before Exemptions Earned Before Korea					
	$1,000	$3,000	$5,000	$8,000	$10,000	$25,000
Amounts of Increase or Decrease (–) in Income After Tax Since Korea *						
Single person—no dependents						
No change	–$17	–$118	–$211	–$385	–$523	–$1,989
5% increase	23	– 1	– 22	–107	–194	–1,478
10% increase	63	115	162	170	135	– 970
15% increase	103	232	347	448	464	– 463
20% increase	143	349	532	724	785	41
Married person—two dependents						
No change	...	– 18	–117	–266	–361	–1,334
5% increase	50	102	83	46	29	– 537
10% increase	100	222	273	357	418	241
Per Cent Increase or Decrease (–) in Income After Tax Since Korea *						
Single person—no dependents						
No change	–1.8%	–4.5%	–4.9%	–5.8%	–6.4%	–11.2%
5% increase	2.4	0	–0.5	–1.6	–2.4	– 8.4
10% increase	6.6	4.3	3.8	2.6	1.7	– 5.5
15% increase	10.9	8.8	8.1	6.7	5.7	– 2.6
20% increase	15.1	13.2	12.4	10.9	9.6	0.2
Married person—two dependents						
No change	...	–0.6%	–2.5%	–3.7%	–4.1%	– 6.6%
5% increase	5.0%	3.5	1.8	0.6	0.3	– 2.6
10% increase	10.0	7.5	5.9	5.0	4.7	1.2

* Taxes on incomes below $5,000 were taken directly from the Supplement T tax table; on incomes above $5,000 taxes were computed on the assumption that deductions amount to 10 per cent of adjusted gross income at all levels.

forms of savings accumulated in the past. The correction in the relative economic position of various taxpayers for the impact of price increases is, therefore, only a first tentative step and cannot be considered as complete. Although this simplifying treatment probably understates the regressivity of the impact of rising prices, the price adjustments made here significantly reduce the differences in tax burdens between various groups of taxpayers.

For instance, a married person with two dependents with a pre-Korean income of $3,000 before and of $2,946 after income tax would have left only $2,688 of his 1952 income of $3,150 (assuming a 5 per cent increase in adjusted gross income) after adjusting for increases in taxes and prices. He would have $258, or 8.8 per cent, less to spend in constant first-half-of-1950 prices. The after-tax income of a single person with no dependents would be reduced by $313, or 11.8 per cent. While the difference between the two groups of taxpayers due to the income tax alone amounted to $103 ($102 plus $1), the difference after the adjustment in prices has been reduced to $55 ($313 – $258). If price increases affected both types of taxpayers in the same proportion, the difference would be $91 ($103 ÷ 1.134) in constant pre-Korean prices. Thus,

TABLE 2

INCREASES OR DECREASES IN REAL INCOME AFTER FEDERAL INDIVIDUAL INCOME TAX FOR VARIOUS HYPOTHETICAL INCREASES IN MONEY INCOME BEFORE TAX SINCE KOREA *

Per Cent Change in Adjusted Gross Income Since Korea	Adjusted Gross Income Before Exemptions Earned Before Korea					
	$1,000	$3,000	$5,000	$8,000	$10,000	$25,000
	Per Cent Increase or Decrease (–) in Real Income After Income Tax Since Korea * †					
	Single person—no dependents					
No change	–13.4%	–15.8%	–16.1%	–16.9%	–17.5%	–21.7%
5% increase	– 9.7	–11.8	–12.3	–13.2	–13.9	–19.2
10% increase	– 6.0	– 8.0	– 8.5	– 9.6	–10.4	–16.7
15% increase	– 2.2	– 4.1	– 4.7	– 5.9	– 6.8	–14.1
20% increase	1.5	– .2	– .9	– 2.2	– 3.4	–11.6
25% increase	5.2	3.7	2.9	1.2	0	– 9.1
30% increase	9.0	7.6	6.7	4.7	3.4	– 6.7
40% increase	16.4	15.4	14.3	11.7	10.1	– 1.7
	Married person—two dependents					
No change	–11.8%	–12.4%	–14.0%	–15.1%	–15.4%	–17.5%
5% increase	– 7.4	– 8.8	–10.3	–11.3	–11.5	–14.1
10% increase	– 3.0	– 5.2	– 6.5	– 7.4	– 7.6	–10.8
15% increase	1.4	– 1.5	– 2.7	– 3.6	– 3.8	– 7.4
20% increase	5.8	2.0	1.1	.2	0	– 4.2
25% increase	10.2	5.6	4.9	4.0	3.6	– 1.1
30% increase	14.6	9.2	8.7	7.9	7.3	2.0
40% increase	23.5	16.4	16.3	15.5	14.7	7.9

* Taxes on incomes below $5,000 were taken directly from the Supplement T tax table; on incomes above $5,000 taxes were computed on the assumption that deductions amount to 10 per cent of adjusted gross income.

† 1952 income after income tax was divided by the ratio of the estimated 1952 average level of the BLS Consumer Price Index to the first half of 1950 level: $\frac{191.4}{168.8} = 1.134$.

the impact of price increases eliminates a significant part of the protection afforded taxpayers with dependents by the system of per capita exemptions. By the same token, the effects of rate graduation under the individual income tax are reduced by the impact of price increases, and the principle of taxation in accordance with ability to pay is weakened (Table 2).

III. *How Large an Increase in Adjusted Gross Income Did Taxpayers Need in 1952 To Be as Well Off as During the First Half of the Calendar Year 1950?*

In order to break even with their pre-Korean real income after federal income tax, taxpayers will have to obtain considerably larger increases in adjusted gross income than those needed to offset the increases in the tax alone. These break-even points are shown in Table 3.

TABLE 3

INCREASES IN ADJUSTED GROSS INCOME LEAVING TAXPAYERS THE SAME AMOUNT OF REAL DISPOSABLE INCOME IN 1952 AS IN JUNE, 1950 *

Selective Levels of Adjusted Gross Income Received Before Korea	Percentage Increases in Adjusted Gross Income Needed to Break Even *	
	Single person—no dependents	Married person—two dependents
$ 1,000	17.9%	13.4%
2,000	19.2	13.4
3,000	20.2	17.1
4,000	20.2	17.9
5,000	21.2	18.5
6,000	21.4	18.9
8,000	23.2	19.7
10,000	25.0	20.1
15,000	31.4	22.1
25,000	43.5	26.8

* Taking into consideration increases in individual income tax rates under the Revenue Act of 1951 and expressing the resulting disposable income in constant June, 1950 dollars.

Bearing in mind that, on the average, taxpayers are estimated to increase their adjusted gross income by close to 25 per cent, the table indicates that married persons with pre-Korean incomes ranging up to and slightly beyond $15,000 would be better off than before the outbreak of hostilities if their income increased at the average rate. Single taxpayers with pre-Korean incomes in excess of $10,000, on the other hand, would need higher than average increases in adjusted gross income to break even. In view of the fact, however, that the average rate of increase itself reflects increases in earnings of persons who were not at work before the outbreak of hostilities, the main interest of the reader should focus on the extent to which taxpayers might be as well off as before Korea although their adjusted gross income increased by less than 25 per cent. Since in 1948, the latest year for which preliminary figures are available, nearly 90 per cent of all tax returns and almost two-thirds of adjusted gross income fell into income classes below $5,000, it may be concluded that a large number of taxpayers will succeed in equaling their pre-Korean real income during the current calendar year.

IV. *To What Extent Were Increases in Incomes Since Korea Absorbed (a) by Increases in Federal Taxes and (b) by Increases in Prices?*

The analysis of changes in real income after the federal individual income tax does not convey an accurate picture of the relative importance of increases in prices and in taxes taken separately. The importance of federal tax increases is understated and that of price increases overstated to the extent that increases in federal taxes assumed to be

shifted to consumers are reflected in the higher price level. Moreover, the individual income tax is not the only tax which is assumed to reduce taxpayers' incomes directly. An attempt is made in the following sections to estimate the impact of all federal taxes (except estate and gift taxes) and to segregate the tax impact from the net impact of price increases adjusted for increases in indirect federal taxes. Both the estimation of effective rates of all federal taxes and the adjustment of the increase in prices for federal indirect taxes depend on the assumptions made with respect to tax incidence and call for the knowledge of consumption patterns at various selected levels of income.

The estimates made in this study are based on the 1948 Survey of Consumer Spending in Detroit, Michigan, conducted by the Bureau of Labor Statistics,[8] and on preliminary information compiled from individual income tax returns published by the Bureau of Internal Revenue.[9] The computations are illustrative and apply only to four-person families living in Detroit, Michigan. They are not of nationwide validity and cannot be generalized to include nonurban families. The last restriction is particularly important since all computations are based on money income exclusive of income in kind which plays a major role in the income of farm families.

[8] United States Department of Labor, Bureau of Labor Statistics, "Consumer Spending: Denver, Detroit, and Houston, 1948," *Monthly Labor Review*, December, 1949, p. 629.

[9] United States Treasury Department, Bureau of Internal Revenue, *Statistics of Income for 1948, Part 1, Preliminary Report*, Washington D. C., 1951.

It is not the purpose of this study to contribute to the discussion of incidence theory. With minor exceptions, the shifting assumptions made are similar to the assumptions adopted as standard cases by Professor Musgrave in his recent study.[10] Suffice it here to list the shifting assumptions made to enable the reader to appraise our conclusions in their proper perspective.

Individual income taxes and employees' contributions under the Federal Insurance Contributions Act were assumed to rest at the point of legal incidence. Employer contributions under the Federal Insurance Contributions Act, unemployment taxes, excise taxes, and customs duties were assumed to be shifted in full to consumers in direct proportion to the money expenditures for the taxed commodities and, to the extent that they increase business costs, in proportion to total consumer expenditures.

The impact of corporation taxes was treated differently in the two time periods considered. During the first half of the calendar year 1950, half of the corporation income tax was assumed shifted to the final consumer in proportion to expenditures for goods and services originating in the corporate sector of the economy, the other half was assumed to be borne by stockholders in proportion to the amounts of dividends received at various levels of income. For the calendar year 1952, the corporation income tax and the excess profits tax at the rates enacted before the establishment of price ceilings (i.e., at the rates under the Excess Profits Tax Act of 1950) were assumed to be borne in equal parts by consumers and by dividend recipients, while the full impact of the rate increases imposed under the Revenue Act of 1951 was assumed to fall on dividend recipients alone. Computations

[10] R. A. Musgrave *et al.*, *op. cit.*

based on the alternative assumption that no portion of the excess profits tax is shifted to consumers were carried out and revealed no significant change in the conclusions presented below. Undistributed profits and the portion of corporation taxes assumed to be borne by stockholders were imputed in proportion to the amounts of dividends received. Results obtained from computations based on the alternative assumption that the nonshifted portion of corporation taxes is partly absorbed by undistributed profits likewise did not affect the results of this study. Under this alternative assumption, only the portion of corporation taxes falling directly on dividend income was imputed to stockholders, while both undistributed profits and the tax thereon were disregarded.

These shifting assumptions imply that increases in employer contributions to social security, increases in excises, and a portion of increases in corporation taxes contributed to increase the level of consumer prices from 1950 to 1952. To isolate the inflationary pressures net of the impact of higher taxes, for the first time undertaken here, it is necessary to eliminate from the increase in the consumer price index the portion attributable to increased taxes. This was done by the following method. It was assumed that total consumption expenditures, both in the pre-Korean period and as estimated for 1952, include the aggregate amounts of federal indirect taxes.[11] Consequently, total consumption expenditures minus shifted federal indirect taxes were assumed to represent the aggregate value of goods and services without federal indirect taxes, and the price index for both periods was adjusted by applying the ratio of the value of consumption expenditures before and after federal indirect taxes. The adjustment is shown in Table 4.

The adjustment would seem to indicate that about one-fourth of the price

TABLE 4

ADJUSTMENT OF THE CONSUMER PRICE INDEX FOR THE EFFECT OF SHIFTED FEDERAL TAXES

	First Half of Calendar Year 1950	Estimated Calendar Year 1952	Ratio of 1952 over First Half of 1950
	Dollar amounts in billions		
1. Consumption expenditures	$186.7	$210.8	....
2. Federal excises and customs duties	7.8	9.4	....
3. Employers' contributions to social security	1.5	2.6	....
4. Shifted portion of corporation taxes	6.2*	11.6	....
5. Total federal taxes assumed shifted (2+3+4)	15.5	23.6	....
6. Consumption expenditures minus shifted federal taxes (1−6)	171.2	187.2	....
7. Consumption expenditures minus shifted federal taxes as a percentage of consumption expenditures (6÷1)	91.7%	88.8%	....
8. Consumer Price Index (BLS): 1935–1939 = 100	168.8	191.4	113.4%
9. Consumer Price Index adjusted for tax effect (8×7)	154.8	170.0	109.8%

* At pre-Korean rates, disregarding the retroactive rate increases enacted in the Revenue Act of 1950.

[11] It might be argued that in the case of manufacturers' excise taxes the tax effect is increased as a result of established pricing practices and markups. Only the net revenue collected was taken into account in the adjustments made in this study.

increases registered since the outbreak of hostilities in Korea represent increases in federal taxes. If it is assumed that no portion of the corporation excess profits tax is shifted to consumers, only 20 per cent, instead of 25 per cent, of the price increases would be attributable to increases in federal taxes.

We now have a rough measure of the price increases. However, only the construction of separate price indexes for different family sizes and for different levels of income could eliminate the errors caused by the use of an average measure.

The results of the application of the adjusted price deflator to 1952 incomes after all federal taxes are shown in Table 5 which lists the changes in in-

TABLE 5

INCREASE OR DECREASE IN REAL INCOME AFTER ALL FEDERAL TAXES (EXCEPT ESTATE AND GIFT TAXES) FOR VARIOUS HYPOTHETICAL INCREASES IN ADJUSTED GROSS INCOME BEFORE TAX SINCE KOREA

Four-Person Family Living in Detroit, Michigan

Per Cent Change in Adjusted Gross Income Since Korea	Selected Levels of Adjusted Gross Income Before Korea				
	$1,000	$3,000	$5,000	$8,000	$10,000
	Per Cent of Increase or Decrease (–) in Real Income After Tax Since Korea * †				
No change	– 13.8%	– 13.1%	– 15.4%	– 18.3%	– 19.5%
5% increase	– 9.5	– 9.5	– 11.6	– 14.3	– 15.4
10% increase	– 5.2	– 5.8	– 7.4	– 10.2	– 11.2
15% increase	– 1.0	– 2.1	– 3.3	– 6.3	– 6.9
20% increase	3.4	1.2	.6	– 2.5	– 3.1
25% increase	7.7	5.2	4.6	1.4	.6
30% increase	12.1	8.8	8.9	5.4	4.3
40% increase	20.6	16.2	16.6	12.9	11.6

* Adjusted gross income plus imputed profits of corporations, plus corporation taxes to the extent that they are assumed to be borne by dividend recipients, minus all federal taxes except estate and gift taxes.

† 1952 income after all federal taxes is divided by the ratio of the estimated 1952 average level of the BLS Consumer Price Index, adjusted for shifted federal taxes, to the first half of 1950 level, adjusted for shifted federal taxes: $\frac{170.0}{154.8} = 1.098$.

impact of price increases since Korea, which is net of increases in indirect federal taxes. The measure is computed on a nationwide average basis. To the extent that the expenditure patterns of families of different size and with different incomes deviate from the set of weights represented by the Consumer Price Index, the application of this average measure to the income after federal taxes of four-person families at various selected levels of gross income may overstate or understate the effect of

comes after all federal taxes since Korea in constant first-half-of-1950 prices. Inasmuch as taxpayers, on the average, are estimated to increase their adjusted gross income from the first half of 1950 through calendar year 1952 by close to 25 per cent, we find that four-person urban families whose adjusted gross income increased at the average rate are significantly better off than they were in early 1950, after the payment of all federal taxes and after adjusting for increases in the cost of living. Families

falling within income classes which represent the bulk of all taxpayers, with increases in gross income of less than 20 per cent, are estimated to break even.[12]

The table is based on sets of effective rates of all federal taxes (with the exception of estate and gift taxes) for the first half of the calendar year 1950 and for 1952 (Table 6). Estimates are presented for four-person families only since the statistical information available did not lend itself to the estimation of the burden of specific excises for single persons.

The findings of the above analysis show that a large portion of the increases in personal incomes stimulated by the expansion of the economy since the outbreak of hostilities in Korea has been absorbed in higher taxes and in higher prices. It is important to know the extent to which either of these factors reduced the level of real income after taxes. Table 7 expresses the contribution of each of the three elements of change—income, prices, and taxes—to the over-all change in real income after all federal taxes; this change is expressed in terms of the levels of income after federal taxes from which the defense effort started.

As Table 7 indicates, reductions in real income after all federal taxes due to increases in the cost of living are sub-

TABLE 6

ESTIMATED EFFECTIVE RATES OF ALL FEDERAL TAXES BEFORE KOREA AND FOR CALENDAR YEAR 1952 * †

Four-Person Family Living in Detroit, Michigan

Selected Levels of Adjusted Gross Income	All Federal Taxes ‡		Individual Income Tax		Social Security Taxes		Excise Taxes and Customs		Corporation Income and Excess Profits Taxes	
	Pre-Korean rates	Calendar year 1952 rates	Pre-Korean rates	Calendar year 1952 rates	Pre-Korean rates	Calendar year 1952 rates	Pre-Korean rates	Calendar year 1952 rates	Pre-Korean rates	Calendar year 1952 rates
$ 1,000	11.7%	16.2%	...	...	2.5%	3.1%	4.2%	4.8%	5.0%	8.3%
2,000	11.7	15.9	...	...	2.5	3.1	4.2	4.8	5.0	8.0
3,000	11.5	15.3	1.8%	2.4%	2.1	2.6	4.0	4.4	3.7	5.9
4,000	14.1	19.1	5.0	6.7	1.8	2.5	3.7	4.1	3.6	5.8
5,000	16.0	21.7	6.8	9.1	1.6	2.2	3.9	4.2	3.8	6.2
6,000	16.9	23.3	8.0	10.7	1.4	2.0	3.3	3.7	4.2	6.9
8,000	19.5	27.1	9.4	12.5	1.2	1.7	3.4	3.7	5.5	9.1
10,000	21.5	29.6	10.4	13.7	1.0	1.5	3.7	3.8	6.3	10.6

* Taking into account the increased rates under the Revenue Act of 1951 and the Social Security Act Amendments of 1950.

† Effective rates of tax are computed on the basis of adjusted gross income plus imputed undistributed corporate profits and corporation taxes to the extent that they are assumed to be borne by dividend recipients.

‡ Exclusive of estate and gift taxes.

NOTE: Detail will not necessarily add to totals because of rounding.

[12] The results obtained under the alternative assumptions discussed above likewise indicate that four-person families would be better off than in early 1950 if their incomes increased at the average rate and also show that increases ranging from 15 to 20 per cent mark the levels of equal real income after all federal taxes.

TABLE 7

PERCENTAGE CHANGES IN REAL INCOME AFTER ALL FEDERAL TAXES SINCE KOREA ATTRIBUTABLE TO INCREASES IN MONEY INCOME, FEDERAL TAXES, AND PRICES *

Four-Person Family Living in Detroit, Michigan

Per Cent Changes in Adjusted Gross Income Since Korea		Selected Levels of Adjusted Gross Income Before Korea				
		$1,000	$3,000	$5,000	$8,000	$10,000
		Per Cent of Increase or Decrease (–) in Real Income After Taxes Since Korea *				
No change	Total difference in real income after federal taxes	–13.8%	–13.1%	–15.4%	–18.3%	–19.5%
	Difference due to increase in income †	– .2	– .2	– .3	– .2	– .6
	Difference due to increase in taxes ‡	– 5.1	– 4.3	– 6.7	– 9.1	– 9.9
	Difference due to increase in prices	– 8.5	– 8.6	– 8.4	– 8.1	– 8.0
10% increase	Total difference in real income after federal taxes	– 5.2	– 5.8	– 7.4	–10.2	–11.2
	Difference due to increase in income †	11.1	11.3	12.6	13.0	13.2
	Difference due to increase in taxes ‡	– 6.9	– 7.8	–10.8	–14.3	–15.6
	Difference due to increase in prices	– 9.4	– 9.3	– 9.2	– 8.9	– 8.8
20% increase	Total difference in real income after federal taxes	3.4	1.2	.6	– 2.5	– 3.1
	Difference due to increase in income †	22.5	22.7	25.0	27.1	27.9
	Difference due to increase in taxes ‡	– 8.7	–11.0	–14.4	–20.0	–21.4
	Difference due to increase in prices	–10.3	–10.5	–10.0	– 9.7	– 9.6
30% increase	Total difference in real income after federal taxes	12.1	8.8	8.9	5.4	4.3
	Difference due to increase in income †	33.5	34.2	39.2	41.2	40.6
	Difference due to increase in taxes ‡	–10.4	–14.6	–19.4	–25.3	–15.9
	Difference due to increase in prices	–11.1	–10.8	–10.8	–10.4	–10.3
40% increase	Total difference in real income after federal taxes	20.6	16.2	16.6	12.9	11.6
	Difference due to increase in income †	44.8	45.8	52.5	53.6	53.2
	Difference due to increase in taxes ‡	–12.3	–18.1	–24.3	–29.5	–30.6
	Difference due to increase in prices	–11.9	–11.5	–11.5	–11.2	–11.0

* All percentages are computed on the basis of pre-Korean adjusted gross income plus imputed undistributed profits of corporations, plus imputed corporation taxes to the extent that they are assumed to be borne by dividend recipients, minus all federal taxes except estate and gift taxes. 1952 income after all federal taxes is divided by the ratio of the estimated 1952 average level of the BLS Consumer Price Index adjusted for shifted federal taxes to the first half of 1950 level, adjusted for shifted federal taxes: $\frac{170.0}{154.8} = 1.098$.

† 1952 adjusted gross income plus imputed income, minus first half of 1950 adjusted gross income, plus imputed income.

‡ Federal taxes are estimated on the assumption that corporation income and excess profits taxes at the rates under the Excess Profits Tax Act of 1950 are borne in equal parts by shareholders and consumers, while all rate increases imposed by the Revenue Act of 1951 are assumed to be borne by shareholders alone.

NOTE: Detail will not necessarily add to totals because of rounding.

stantial at all levels of and for all hypothetical increases in adjusted gross income. The relative burden of price increases compared to that of tax increases is heaviest on lowest incomes. Four-person families with pre-Korean incomes of less than \$3,000 find their real income reduced more heavily by price than by tax increases throughout the whole range of hypothetical increases in nominal incomes up to 40 per cent. At the \$3,000 level, price increases weigh more heavily than increases in federal taxes for families whose nominal income increases up to almost 20 per cent; at the \$5,000 level, tax increases are more burdensome than price increases when nominal income increases 10 per cent or more; and at the levels of \$8,000 and \$10,000, the contribution made in taxes relegates price effects to the second place even if no increase in nominal incomes has occurred since Korea.

The increase in the cost of living alone is seen to offset increases in gross income up to nearly 10 per cent at the lower end of the income scale and about 7 per cent at the highest income levels covered in this study, the difference being accounted for primarily by the larger amounts of imputed corporate income and taxes.[13]

The order of magnitude of the burdens added by the rise in the cost of living may be measured in terms of the increases in federal taxes since Korea. A four-person family earning the same income of \$1,000 during the first half of 1950 and during the calendar year 1952 will find its real income 1.67 times as much reduced by higher prices than by higher taxes, or by \$1.67 for each dollar of increase in federal taxes since Korea. At the \$10,000 level, where the impact of taxes is heavier, the rise in the cost of living adds 80 cents to each dollar of additional taxes.

The relative burden of the rise in the cost of living, as compared to that of tax increases, declines as families succeed in increasing their gross income. At the \$3,000 level, for instance, the effect of price increases matches that of federal tax increases almost dollar for dollar for families whose gross income increases 20 per cent, and it amounts to less than two-thirds of the added tax burden if gross income increases 40 per cent. Yet, even a family at the \$10,000 level whose income increases 40 per cent to \$14,000 gives up 36 cents in higher prices for each additional dollar in taxes.

V. *Conclusions*

Subject to the qualifications noted in the preceding discussion, our analysis leads to the following tentative conclusions which are presented for four-person families living in Detroit, Michigan.

1. Four-person families living in Detroit, Michigan whose adjusted gross income has increased at the average rate of 25 per cent since Korea are estimated to obtain increases in real income after all federal taxes ranging from .6 per cent at the \$10,000 level to 7.7 per cent at the \$1,000 level.

2. The vast majority of families (with pre-Korean adjusted gross incomes ranging up to \$6,000) would be left with approximately the same real income after taxes in 1952 as before Korea if they obtained increases in adjusted gross income of less than 20 but more than 15 per cent.

[13] The problem of the extent to which increases in income and in prices are interrelated—i.e., increases in income are caused or made possible by price increases or price increases are made necessary by increases in factor income—lies beyond the scope of this study.

3. The findings under (1) and (2) are not changed (a) if, instead of the shifting assumptions made in this study, it is assumed that no portion of the excess profits tax is shifted to consumers or (b) if undistributed corporate profits and corporation taxes thereon are not imputed to shareholders but are disregarded.

4. If it is assumed that a portion of the excess profits tax is shifted to consumers, the effect of increases in indirect taxes is estimated to account for 25 per cent of the increase in the cost of living since Korea (20 per cent, if the burden of the excess profits tax is assumed to be borne in full by dividend recipients).

5. Increases in the cost of living reduce real income more than federal taxes at the lowest levels of income and at middle income levels if moderate increases in adjusted gross income are obtained. At the highest levels of income the burden of tax increases outweighs that of price increases regardless of increases in gross income.

6. The reduction in real income due to the rise in the cost of living amounts to at least 36 cents for every dollar of federal tax increases, and it ranges as high as $2 for every dollar of additional tax according to the levels of and increases in adjusted gross income.

TAXES AND INDUSTRIAL LOCATION

JOHN D. GARWOOD *

Introduction

DURING the last two decades in the United States, the shibboleth of the acceptability of a tax program in many municipalities and states has been the incidence of such a program upon the area's industrial development. Yet at the same time, the result of tax differentials and tax exemption upon location and relocation of industry is not at all certain. It is clear, however, that the practice of pointing tax and subsidy programs toward industrial development has been zymotic in effect. Competitive tax and subsidy programs were stimulated and reached their peak during the decade of the thirties when city and state governments sought solutions to their unemployment problems. Today states and municipalities continue to stress tax differentials as incentives for location.

There has been a rather widespread misconception that obtaining new industry for a community means merely going out and persuading some industry that the area with which a development group is concerned is so desirable that the industry would have economic advantages there which would more than offset the cost of moving. There is a great deal of evidence which would seem to indicate that this reason alone would not suffice to move any industry which was not already dissatisfied with its present location.

There are many factors which influence industries in their location. These factors include the materials used in production, nearness to markets, availability of labor and the quality of that labor, means of transportation, power and fuels, and availability of desirable sites. For most firms these factors dominate the location process.

The desire of each industry-minded community to obtain new industrial operations often leads to keen competition among the communities and states. Some areas endeavor to sell themselves largely on the basis of attractive living, scenery, recreation, and climate. In elaborate brochures development groups seek to show that their city, town, or area is the ideal location for almost any industry.

The tax structure of any governmental unit represents a potential cost which any prospective entrepreneur must assume should he locate in the area. Some communities have attempted to create a favorable industrial environment through the medium of lower taxes for new industries. It is the contention of the writer that the tax structure of a community has but little to do with the orientation of industry to that community.

* The author is associate professor of economics at Fort Hays Kansas State College.

Industrial Location and the Tax Program

If a firm could neglect all factors of location but that of taxation, the problem would still be very complex. The 48 states and thousands of municipalities differ in their methods and rates in the tax field. A firm would need to analyze carefully the nature of its assets, i.e., whether they would require great amounts of land, machinery, stocks of goods, intangibles, etc. In some states certain properties are exempt from the property tax. Thus, the prospecting firm would be interested in states where exemptions of property from the property tax are sizable. In the past, for example, Alabama exempted mortgages, bank deposits, and certain raw materials. In addition, new factories might be granted a ten-year property tax exemption. Louisiana in the past exempted cash and bank deposits, legal reserves of domestic life insurance companies, all cattle, ships, and certain manufacturing or commercial property on the navigation canal of New Orleans. The list of exempt property is different from state to state; thus, it might pay the organizers of a migrant firm to check the exemption list of the various states.[1]

In addition to exempt property which makes appraisal of a tax structure more difficult, there is a great amount of discrepancy in assessments among the various states as well as among the counties of individual states. In a study made by the Detroit Bureau of Governmental Research in the mid-thirties, the ratio of assessed value to the legal basis of assessment varied from 37 per cent in the city of Chicago to 100 per cent in Jersey City.[2]

Besides the property tax, a firm would need to check business taxes such as the general franchise tax, state income tax, sales and license taxes, occupation taxes in some states, severance taxes, and in some states discriminatory taxes such as the chain store tax and the tobacco and margarine taxes.

The executive of a firm may be able to obtain a picture of the present tax structure, but he has no assurance that the picture may not be altered considerably by future legislatures and by changing economic conditions. If the firm must invest large amounts of fixed capital and if the costs of moving and locating constitute heavy expenses, then any location or relocation because of a favorable tax structure must be analyzed carefully. The assessing procedures might be drastically overhauled, new levies imposed, local government units abolished or consolidated with resulting changes in the fiscal picture. In 1926 the federal government stepped into the inheritance and estate tax field and enacted legislation which was intended to equalize state inheritance taxes. Such a move is conceivable in the field of business taxes.

Another factor is that of governmental service. Although a state's tax structure may appear favorable from the point of view of taxes collected, it may very well be that essential government services are so neglected that an establishment would face additional costs in providing these services for itself. A firm can afford higher tax rates

[1] Tax Policy League, *Tax Policy*, Vol. IV (October, 1937), pp. 17-22.

[2] *Ibid.*, pp. 22-23.

if services such as fire protection, public health and recreational facilities, and local transportation facilities are adequate. A taxpayer should be interested in getting the most for his tax dollar.

During the decade of the thirties, separate studies were made in the states of Wisconsin, New York, and Pennsylvania as to the effect of state tax programs on industrial development in these states.[3] The study in Wisconsin did not give any indication as to whether taxes were important in industrial location. Although the special business taxes were heavier in Wisconsin than in the five other states which were utilized for a basis of comparison, they did not seem to influence industrial location or relocation of industry to a very great extent.

In the New York study, executives of 249 manufacturing establishments which left New York City between 1931 and 1935 were questioned as to their reasons for seeking other locations. One hundred and forty manufacturers stated that racketeering in business and labor was the chief cause, 37 stated that high rents caused the move, 35 noted that high taxes caused them to leave, while others mentioned high transportation costs, overhead costs, high insurance rates, etc. C. E. Murphy, author of the study, commented that perhaps a prime cause of relocation was that of inducements offered from other communities.

The Pennsylvania investigation pointed up the fact that industries with heavy investments were not so likely to be enticed by communities with lower tax rates. They came to the conclusion that cheaper and less unionized labor was more of a locational factor for firms leaving Pennsylvania than differentials in tax rates.

Another study made in Wisconsin of income tax returns of Wisconsin metal manufacturing corporations showed that state and local taxes approximated about 1.65 per cent of the total cost of manufacture; the division being state taxes, .63 per cent, and local taxes, 1.02 per cent. Although Wisconsin was regarded as a " high tax state " at the time of the study, it seems likely that a small alteration in wage costs or costs of material would be of much more importance for location than would a change of location to escape taxation.[4]

During the decade of the thirties when states competed vigorously for industries, a threat of relocation was held over the heads of state legislatures and the governing bodies of municipalities. It appears that in a number of cases the laws were adjusted accordingly. Tax concessions were used frequently among city governments and even among the states. Cash bonuses, loans, donations of site and buildings, guarantees of favorable labor conditions, etc. were commonly utilized in the scramble for mobile industries. Some states permitted municipalities to exempt new industries from property taxation for periods of from five to fifteen years.

The state of Mississippi under a " Balance Agriculture with Industry " law permits public borrowing to buy or build plants to lease to private industries. Thus:

[3] *Ibid.*, pp. 4-16.

[4] H. M. Groves, " Effects of Tax Exemptions and Tax Differentials on the Location of Business," *National Tax Association Proceedings*, 1938, pp. 538-539.

. . . When and after a municipality shall have obtained therefore a certificate of public convenience and necessity . . . then it may acquire land by purchase, gift, eminent domain or otherwise for any such enterprise so thus approved and may directly or by contract obtain for such enterprise the requisite appliances and equipment, and may operate such enterprise . . . . The said municipality having been authorized by the board . . . may expend for acquiring and operating such municipal enterprise, under rules and regulations adopted by the commission. Said municipality is hereby authorized from and after the effective date of this act, to issue bonds of such municipality for the purpose of effectuating the provisions of this act and promoting thereby the public welfare of this state in bringing about the general welfare of its people.[5]

In a study made by W. F. Eiteman of corporation franchise taxes and location, it was concluded that high franchise taxes do not "ordinarily place a burden on domestic corporations that do business outside the state or give foreign corporations an advantage over domestic corporations in doing business within the state." [6]

The writer recently completed a study of the location processes of 116 firms which initiated manufacturing operations in Colorado and Utah from January, 1946, through April, 1951. The major part of the data concerning location policies as evidenced by new industrial operations in these two states was gathered by personal interviews with officials and owners of the firms. It is the opinion of the writer that fully 90 per cent of all new manufacturing firms in Colorado and Utah employing ten or more workers were included in the study. These new firms produce steel and steel products, refined copper, processed uranium, gypsum building materials, creosoted wood, petroleum products, salt, clothing, food and kindred products, machinery, glass bottles, furniture, magazines, chemical products, aluminum pistons, batteries, and many other products of a miscellaneous nature.[7]

Five major economic forces were responsible for attracting these firms to Colorado and Utah. In order of importance, these forces were markets, materials, labor, available sites and plant facilities, and climate. Certain other influences of a more secondary nature were also noted by representatives of the new firms. A few plants were established in these two mountain states for purposes of "decentralization." The attractiveness of the cities on the eastern slope of the Colorado Rockies was a factor of some import for several of the owner-operated firms.

In no instance was the tax structure of either state deemed a factor of any consequence as far as location policy was concerned. Thus, other cost factors completely dominated the location analysis. Many company officials and company owners had only a vague idea of the tax structure in these two states.

It appears likely that the postwar industrial migration to Colorado and Utah was neither hampered nor helped

[5] "Balance Agriculture with Industry," House Bill 176, State of Mississippi, 1944, pp. 6-10.

[6] W. F. Eiteman, "Effect of Franchise Taxes upon Corporate Location," *Southern Economic Journal*, Vol. 9 (January, 1943), p. 240.

[7] This study was submitted in the form of a doctoral dissertation to the economics department of the University of Colorado in July, 1951.

by the tax structure in these two states. In 1949 state taxes in Colorado and Utah were equal to approximately 5½ per cent of the income payments to individuals in these two states. Total state taxes in the same year were about 4½ per cent of income payments to individuals in all states.[8]

A few company officials noted that the Colorado property tax was heavier than that paid in other states. The owner of a firm recently moved to Colorado from Missouri commented that his company, which carried a large inventory, was penalized by the Colorado property tax. The tax, however, in no way dissuaded the company as to the advantages of the western location.

Conclusion

Taxation differentials do not represent much of a " pull " in industrial location. The State Planning Board of the state of Indiana commented as follows:

> The State Planning Board of Indiana has amassed a great deal of information pertaining to industry and employment, and although these data have not been thoroughly analyzed, it is our opinion that taxation has had but little to do with the localization or shift of industry into or out of the State as compared to other factors as labor, nearness to markets, nearness to raw materials, transportation facilities, and inducements held out by various local Chambers of Commerce. There has been but little movement of industry either into or out of the State and of these none has been due to taxation that we know of.[9]

It is high time that the relationship of the tax structure to industrial location and relocation be reassessed in its true light. Too many governmental units have given taxes a disproportionately important place in industrial cost analysis. The policy of maintaining lower taxes to attract new industries may result not only in the lowering of state revenues, but the new industries themselves are likely to require additional public expenditures for increased public services. Governmental representatives should acquaint themselves with something which business has known for a long time, i.e., state and local tax structures are of relatively small importance in orienting or deterring industrial location.

[8] *Tax Systems, 12th Edition* (New York: Commerce Clearing House, 1950), p. 301.

[9] George A. Steiner, "The Tax System and Industrial Development," *Bulletin of the National Tax Association*, Vol. 23 (January, 1938), p. 98.

CLINICS, BENCH MARKS, AND IMPROVED ASSESSMENTS *

WILLIAM G. MURRAY AND GORDON E. BIVENS †

AN EXPERIMENT in improving assessments through clinics at which bench mark properties are assessed was started in Iowa in 1951. The first clinic, a state assessor school, was held at Iowa State College in September, 1951. Three farm tracts, a set of farm buildings, four residences, and two commercial properties were set up as bench marks and assessed by the 142 assessors in attendance at the clinic. Several district clinics were held in 1952 in preparation for the state quadrennial real property assessment in 1953.

Clinics or assessment comparisons of key properties are carried on in conjunction with a continuing study of assessment-sale ratios.[1] The two programs constitute a basic approach to the attainment of equalization between properties within a taxing district (internal equalization) and between taxing districts (external equalization).

A favorable environment in Iowa for the clinics was provided by the interest among assessors in improving assessments. This interest can be traced to the 1947 law, amended in 1949, which abolished the elected township assessor and in his place created the county and city assessor appointed by a conference board made up of county, city, and school representatives. Activity among the assessors since 1947 has shown itself in a revitalized state association of assessors, a monthly bulletin made up largely of contributions from individual assessors, regional meetings usually on a monthly basis, and sponsorship and assistance in the state and district clinics.

State Clinic

The plan of the state school was a talk on theory or a discussion followed by a field assessment which, in turn, was followed by a discussion of the assessment reports. For example, a morning session in charge of agronomists was given over to soils talks and practice in identification of different kinds of soils. This was followed by the field assessment of the farm tracts after lunch. Late in the afternoon the whole group reassembled to discuss the assessments turned in by the assessors.

* Journal Paper No. J-2175 of the Iowa Agricultural Experiment Station, Ames, Iowa. Project No. 1069.

† The authors are members of the department of economics and sociology at Iowa State College. Mr. Murray is head of the department and Mr. Bivens is extension associate.

1 "Improvement in Real Estate Taxation Through Assessment-Sales Studies," by William G. Murray, *National Tax Journal,* V (March, 1952), p. 86.

The attendance of 142 was divided into eleven groups to increase the effectiveness of the field work. Each of the groups had as a leader an assessor recommended for the position by the assessors at their district meetings. Each participant was given a card on which he was required to report his assessment to his group leader. Each card bore a number keyed to the assessor's name when he registered. In this way the assessor did not need to sign his assessment report, and yet his report could be identified for statistical purposes. The number served also to establish eligibility for certificates. Only those assessors who turned in assessments for at least two out of the three classes of property were considered eligible for the certificates awarded at the end of the school.

Three classes of property—farm, residential, and commercial—were selected for intensive study at the state school. Individual properties for use in the clinic were chosen in advance of the school by a committee of assessors. The objective was to select typical properties that would serve as bench marks for all assessors. On the farm selected, comprising 240 acres, three 40-acre tracts were picked out to serve with the set of farm buildings as a bench mark or key assessment. Each of the 40-acre units represented a different type and value of farm land. Similarly, four residential and two commercial properties in the city of Ames were picked to represent their respective classes.

TABLE 1

Group Number	40-Acre Tracts			Farm Buildings	Total
	No. 1	No. 2	No. 3		
1	$4,759	$3,806	$2,814	$ 9,386	$20,765
2	4,325	3,719	2,332	9,906	20,282
3	4,481	3,748	2,783	10,937	21,949
4	4,304	3,332	2,481	9,985	20,102
5	4,121	3,242	2,313	10,032	19,708
6	4,587	3,159	2,576	11,481	21,803
7	4,747	3,749	2,771	10,548	21,815
8	4,069	3,358	2,403	10,032	19,862
9	3,970	3,420	2,560	10,260	20,210
10	4,554	3,554	2,845	10,472	21,425
11	4,487	3,266	2,725	9,833	20,311
A. Average of Groups	$4,400	$3,487	$2,603	$10,261	$20,751
B. Average of Individuals	$4,249	$3,465	$2,578	$10,141	$20,572
C. Standard Deviation of Individuals	$ 575	$ 604	$ 581	$ 1,899	$ 2,600
D. Coefficient of Variation of Individuals	14%	17%	23%	19%	13%
E. Present Assessment	$4,278	$3,611	$2,949	$10,604	$21,442

Information on the clinic properties was obtained in advance of the school to save the assessor's time. This information included that which the assessor would normally gather such as measurements, soil data, sales figures, photographs, and the like. Each assessor was given this information so that the routine activity in assessment was reduced to a minimum, leaving a maximum of time for figuring and arriving at the final assessment for the property.

Farm Properties

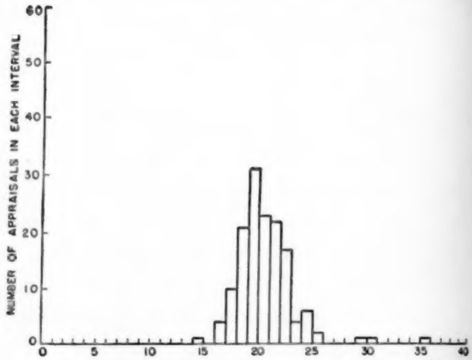
Results of the farm assessment as they were reported by the eleven group chairmen are shown in Table 1.

Most of the assessors and the school staff as well were surprised at the uniformity among the groups. The results gave the assessors a feeling of confidence generated by the fact that every one of the groups had come close to the general average. Of course, the use of groups obscured the individual variations which were brought out later in a chart showing the distribution of the individual assessments.

A special advantage of the group report is the emphasis it gives to the central tendency which is generally the bench mark value on which all assessors should be agreed. If there is wide fluctuation among the groups, the assessment administration has tangible evidence that there is little uniformity among the assessors. Either the assessors are assessing on different levels or are unable to appraise property with reasonable accuracy. To meet such a situation, the administration has a task in establishing a value level and training the assessors to appraise and to assess on the established level.

A striking contrast between the clinic reports and the present assessment was revealed in the reports on farm tract No. 3. The highest group average on this tract was $2,845, while the actual assessment was $2,949. And the average for all assessors reporting was only $2,578. What made this situation noteworthy was the fact that this tract is made up of low grade land which is difficult to appraise accurately and is a type frequently overassessed. It was generally agreed that the present assessment on tract No. 3 was about $400 too high.

Evidence that the assessors had trouble with tract No. 3 was supplied by the coefficient of variation which measures the spread around the average. There was more variation on tract No. 3 than on any other farm tract or on the set of farm buildings. The total assessed value, it should be noted, had the least variation, an indication that some of the assessors made compensating errors. Or to put it another way, the assessors were more accurate in judging the value of the property as a whole than in valuing the individual parts.



INDIVIDUAL FARM PROPERTY ASSESSMENTS

Values in Thousands of Dollars (Land & Buildings)

Fig. 1

The second lesson for the assessors was the distribution of the individual assessments as shown in Figure 1. The large number of assessors who turned in total values between $18,000 and $22,000 explains the closeness of the group averages. But the existence of fifteen reports below $18,000 and of fifteen reports of $23,000 or more indicates a sizable minority who need more training in valuation or in recognition of the current value level being used in assessment.

Residential and Commercial Properties

Results of the assessment of the four houses and two commercial properties were comparable to those on the farm but with less concentration around the

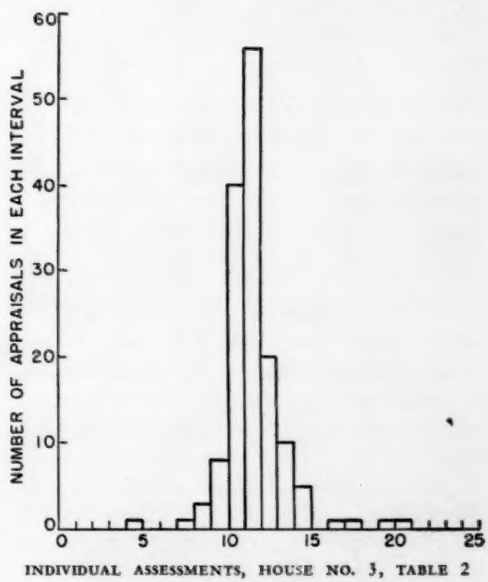
average. Since the groups came out similar to the farm example, only the summary figures are presented in Table 2.

Among the houses there were two interesting results: the wide variation on No. 2 and the large spread between the average and the actual assessment on No. 3. House No. 2 is an apartment-type rooming house made over from a former one-family residence. The assessors had difficulty on this unit because it was relatively old, and they found it hard to estimate gross and net income of the property as a rooming house. The coefficient of variation of 25 per cent on this property presents a marked contrast with the coefficient of 16 per cent on residence No. 3. (See Figure 2.) In the case of No. 3, all group averages were below the present assessment. Residence No. 3 was built in 1937, while No. 4, a modern ranch type, was built in 1950. All of the groups assessed No. 4 higher than No. 3. An excellent job was turned in by the assessors on No. 1, a relatively simple, inexpensive frame-type house.

Both of the commercial properties gave the assessors trouble. "A" is a new super-market structure with which many of the county assessors were not familiar. "B" is an old, remodeled building, the income of which was difficult to estimate. The wide variations of assessments on both of these properties are indicated by the coefficients of variations of 30 and 28 per cent. The wide range of individual reports is shown in Figure 3. The coefficients of variation for commercial properties, when compared with those on the other clinic properties, are sufficiently high to warrant special attention.

TABLE 2

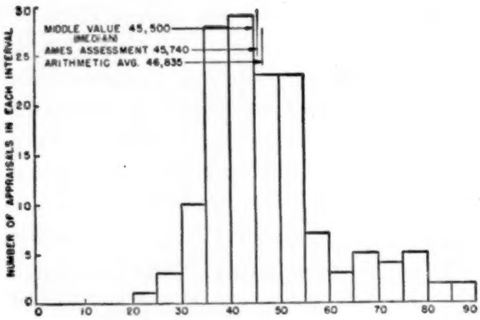
	Houses				Commercial Units	
	No. 1	No. 2	No. 3	No. 4	A	B
A. Average of Groups	$4,311	$7,259	$11,453	$12,136	......	......
B. Average of Individuals	$4,191	$7,325	$11,458	$12,254	$42,542	$46,482
C. Standard Deviation of Individuals	$ 643	$1,808	$ 1,847	$ 2,167	$12,792	$13,144
D. Coefficient of Variation of Individuals	15%	25%	16%	18%	30%	28%
E. Present Assessment	$4,570	$6,435	$12,640	$11,815	$46,105	$45,740



INDIVIDUAL ASSESSMENTS, HOUSE NO. 3, TABLE 2

Values in Thousands of Dollars

Fig. 2



COMMERCIAL PROPERTY B

Values in Thousand Dollars

Fig. 3

District Clinics

Three houses, a set of farm buildings, and two farm tracts were valued in April, 1952, by eleven assessors representing eight counties and three cities in central Iowa. The results (see Table 3), as in the state clinic, showed close agreement for the most part between the clinic averages and present assessment. The one important exception was farm values. According to the clinic, the present assessment on the buildings was around 14 per cent too low and the land about 20 per cent too high. An explanation for the land differential is based on a state equalization ruling in 1949 which raised all farm land and building valuations by 15 per cent. But, of course, this same equalization made the building disparity less than it would have been without the countywide equalization.

House No. 1, an old structure, presented several appraisal problems. Its age was difficult to estimate; it had been remodeled recently, including the addition of new wood siding. Both house No. 2, built in 1947, and house No. 3, built in 1952, presented fewer problems and allowed the assessors to apply their current building cost data with relatively small depreciation estimates. The small variation among the assessors on these newer properties, as indicated by the coefficients, points up the relative ease with which assessors are able to handle these properties. This difficulty of assessing old houses was brought out in an assessment-sale study for 1951 in which the 31 sales of new houses had a ratio range of 19 to 26 per cent, while the 25 sales of houses built before 1915 ranged from 8 to 57 per cent.

One of the noteworthy features of the district clinic was the active discussion which took place among the assessors after the results were obtained. Two of the assessors who were low on houses No. 2 and No. 3 came from counties with no large towns. They contended that building costs in their

TABLE 3

Property	Range of Values	Average Value	Present Assessment	Coefficient of Variation (Standard deviation as a per cent of the average)
House No. 1	\$1,700–\$4,575	\$2,585	\$3,000	29%
House No. 2	2,900– 5,000	4,406	4,200	16
House No. 3	2,500– 5,200	4,248	4,250	19
Farm Buildings	4,300– 6,590	4,912	4,244	15
First 40-Acre Tract	85– 145	106	132	18
Second 40-Acre Tract ...	100– 125	113	132	9

towns were much lower than in the larger town in which these key properties were located. Although general agreement was not reached, the assessors were able, in this instance, to bring their differences out into the open in a clear-cut manner. Whether the differences are a reflection of building costs or a lack of uniformity can be determined in part by a study of assessment-sale ratios.

Future of Bench Mark Clinics

Property assessment can be improved through the use of bench mark clinics. There is nothing new, it is true, in the idea of bench mark or key properties. Appraisal firms doing mass assessment contracts have long had standard or key properties. In urban areas the use of the A, BBB, BB, B bench mark system, or variations of it, for residential and commercial properties is common. In farm appraisal the use of key properties and classification systems is growing. In Germany, as early as 1926, a tax assessment system for farm lands was established which provided for an elaborate key farm system so that each individual farm or tract could be compared with local key properties, which in turn were compared with district, and they in turn with one nationally known farm in Saxony which was rated as 100. But with all this emphasis on key properties, little has been done in bringing assessors together to assess these bench mark or key properties and to discuss their differences. The reason, in part, undoubtedly has been the lack of interest on the part of the assessor. And this lack of interest is understandable for those cases where the assessors are elected and do not stress professional skill and success in assessment. As more states shift to appointed assessors, the opportunity will increase to improve assessments through the two-point program of assessment-sale studies and bench mark clinics.

BOOK REVIEWS

The General Manufacturers Sales Tax in Canada. By JOHN F. DUE. (No. 3 in series of Canadian Tax Papers.) Toronto: Canadian Tax Foundation (4 Carlton Street), 1951. Pp. 202. $2.00.

Business groups in the United States periodically urge Congress to adopt a federal sales tax, preferably a manufacturers sales tax. We are reminded that Canada has had 30 years of experience with such taxation, and that it survives changes in administration there. Indeed, in 1951 the rate was increased from 8 to 10 per cent on taxable items. This year the tax will yield about $600 million, or 16.1 per cent of total federal revenues in Canada.

We are indebted to Dr. John Due for an excellent examination of the Canadian tax. Due has given us an historical perspective of the development of the manufacturers tax out of a four-year experiment with a modified turnover tax during 1920-1923. Debates in the Parliament are summarized to contrast the positions of the opposition and of the government. Depression and wartime experience, as well as current anti-inflationary use of the tax, are all accorded sympathetic treatment.

It is a bit unusual to read any treatise on a particular tax which is written with a high level of competence from so many points of view. In addition to a scholarly treatment of the history, Due demonstrates

complete competence in the field of tax administration and tax law. More than that, his well-known ability in economic theory generally, as well as in the special field of price theory, all shine through this text.

Teachers, administrators, and taxpayers alike will appreciate his careful dissection of the body of the tax as, for instance, he examines the provisions to avoid multiple application of the tax and the provisions for exemption, whether for reasons of equity, constitutional limits, administrative convenience, or other reasons. Judicious treatment is given each one.

Yet the work never bogs down in detail. Both supporters and critics of sales taxes, and particularly of the manufacturers sales tax, will appreciate the dispassionate care with which Due discusses problems of administration, compliance, and information to taxpayers. Notwithstanding the detail necessary for this purpose, the main and fundamental issues are repeatedly brought clearly into view.

Due's findings with respect to shifting, pyramiding, and incidence will appear familiar to most readers of this *Journal*. With the others who have written here in recent years, he finds that the tax, because of the exemption of many food items, tends to be slightly progressive at the very low-income end, roughly proportional over the middle-income range, and regressive in the upper-income brackets (actually, after $3,550).

As a competent price theorist, he avoids the easy generalizations to which most protagonists in this field are prone and does a carefully reasoned job on examining shifting and incidence under a number of different conditions. The conditions under which pyramiding may take place, as well as the limits, are cautiously set forth.

The closing chapters of the work contain a balanced treatment of the role of the tax in the tax structure, both as a permanent element and as an anti-inflationary measure. The case for a federal manufacturers tax as against a provincial retail tax or some combination of federal-provincial sales tax is reviewed, and it will be of interest to students of federal-state relations in the United States as well. The equity, administrative, and incentive considerations are all called into view.

In comparing the sales to the income tax in his summary, Due has contributed a useful tool, the reviewer believes, in his insistence that—

> To a large extent the claimed superiority of the sales tax, on the basis of incentive effects, rests upon the less progressive distribution of the burden with such a tax compared to that with an income tax, rather than to inherent differences between the two types of tax. The correct comparison, for purposes of incentive considerations, is between a sales tax and an income tax which would be distributed in the same manner as the sales tax over various income groups. (p. 152)

Although Professor Due personally prefers the provincial retail sales tax to the dominion manufacturers sales tax, and has given ample reason for the preference, he does not let his own preferences prevent him from offering a wide variety of suggestions designed to make the dominion tax more nearly desirable from all points of view.

The Canadian Tax Foundation is to be commended for securing the services of so competent a worker to do this report and for publishing its findings so that the United States can vicariously learn from Canadian experience.

(The Canadian Tax Foundation is a nonprofit organization established by the joint action of the Canadian Bar Association and the Canadian Institute of Chartered Accountants to encourage and undertake study in the field of taxation in Canada. Its work is directed towards the improvement and wider public understanding of the Canadian tax system.)

BYRON L. JOHNSON

Denver

Neuordnung der Oeffentlichen Haushalte by Dr. Herbert Weichmann and Dr. Curt Wawrczeck. Publications of the Hamburgische Welt-Wirtschaftsarchiv No. 3, Verlag Weltarchiv GMBH., Hamburg, Germany, n. d. Pp. 99 and attached forms.

This book was prepared on request of the Senate of the Free and Hanse City of Hamburg as a contribution to the current discussion of budget reform in the Federal Republic of Germany. One of the authors is president of the General Accounting Office of Hamburg, and the other is one of his aides. Their experience has been with the finances of Hamburg, a public body which combines features of a state (Land) with those of local government. The proposal is meant to apply to the central government and to be used as a unified approach to budgeting by all levels of government, federal, state (Land), and local.

The subtitle of the book, in literal translation, is: "A Contribution to the Economic, Public Finance, and Management Planning of the Public Administrative and Financial Economy." The authors' budget philosophy reflects their government philosophy. They recognize that government today has become an important factor in the process of production and distribution as well as in the formation and utilization of national wealth. The planning of government functions must be closely related to an appraisal of the functions performed by the private economy. And the management of public functions must be scrutinized as closely as the management of a private concern by their board of directors. The traditional classification of budgets which reflects mainly the institutional structure of government gives neither the government planner and manager nor the citizen the information that is needed under present-day circumstances.

The authors have studied the budget reform movements in other countries, particularly in the German Democratic Republic (Eastern Germany), Switzerland, and the United States. They recognize that each of these reforms has desirable aspects but that none satisfies fully the need for a complete reorientation of the budget in accord with government functions in the present economy. The authors praise, for instance, the intentions of the "performance budget" proposed by the Hoover Commission. They criticize the proposal, however, because it uses program budgeting only as a secondary principle subordinated to the conventional institutional classification by major government organizations.

The authors reverse that emphasis and propose to subordinate the classification by agencies to the classification by major government tasks. They believe that only thereby it becomes possible to relate government programs to functions performed by private business and to afford an over-all appraisal of the use of national resources.

For each of the programs they propose a classification according to overhead administration, program execution, investments of various character, and grants to other units of government. The program budget is supplemented by a finance budget. The question as to who benefits from the program should, according to the authors, be closely related to the question of who pays for them. Consequently, they emphasize fees and specific contributions where they are compatible with the purposes of the program.

The budgets distinguish between statements of current expenses and statements concerning transactions in real and financial property, in this respect further improving the practice of a capital budget adopted, for instance, in Switzerland.

The book ranges from a statement of philosophy (also emphasized in a preface by Kurt Heinig, the foremost authority on history and practices of budgeting in various countries) to the presentation of an elaborate and complex schematic system of classifications, and, finally, to an illustrative breakdown of the budget figures of the City

of Hamburg in accordance with the proposed new classification. These illustrations clarify the authors' intentions but also indicate the practical difficulties of converting the traditional classification into the new one.

The authors combine broad vision with technical competence. The proposals are so far-reaching, however, that I think the book will prove more useful in stimulating discussion than in presenting a plan that could readily be adopted. I wish the authors' ideas could also be read in this country where the discussion of budget classification has been largely limited to a small group of technicians. To make this book useful outside Germany, however, more than a translation would be needed. For one thing, the authors use a technical jargon largely grown out of German local budget practices which makes the book hard reading even for those who are familiar with the German language. Furthermore, the authors seek to make budgeting a better instrument of program planning and program appraisal. But they fail to relate the aspect to the specific process of legislative appropriation. If I understand the proposal correctly, this reform of the budget, if adopted in this country, would require a drastic change in the whole philosophy and technique of budget determination by Congress. This is not necessarily a criticism of the proposal. But the book does not discuss the consequences the proposal would have with respect to budget legislation, either in Germany or anywhere else.

GERHARD COLM

Washington, D. C.

Federal Taxes. Edited by CLIFTON H. KREPS, JR. New York: The H. W. Wilson Co., 1952. The Reference Shelf, Vol. 24, No. 2. Pp. 183.

This book is a collection of recent articles and extracts dealing with tax problems of general interest. The four major topic headings are: Magnitude, purposes, and effects of federal taxation; Equity in taxation—distribution of the burden; Taxation, defense, and inflation; Should federal tax powers be limited?

A leaflet listing *Census Bureau Publications on Governments* has been issued by the Bureau of the Census and is available from that agency upon request. This bulletin describes briefly each of the 16 reports on governmental finances and employment which the Census Bureau expects to issue in the fiscal year beginning July 1, 1952, and lists other recent publications of the Bureau regarding state and local governments.

NTA NOTES

1954 CONFERENCE SITE AND DATES SELECTED

In the September issue we announced the holding of the 1953 National Tax Conference in Louisville, Kentucky on September 28 to October 1. Since that announcement was written, the Executive Committee has decided upon the time and place of the 1954 Conference. It is to be held in Bretton Woods, New Hampshire on September 27 through October 1. Headquarters are to be at the Mount Washington Hotel.

The 1954 conference will be the first one held at a resort hotel since we met in Miami Beach in 1947 and the first in a rural setting since the 1929 conference at Upper Saranac, New York. It will be the second meeting at Bretton Woods, the first one having been held there in 1921.

RONALD B. WELCH
Secretary

NEW MEMBERS

CALIFORNIA

Mr. John R. Anderson, Secy-Treas.
Basalt Rock Company, Inc.
8th and Rivers Streets, Napa

DISTRICT OF COLUMBIA

Mr. Eugene F. Bogan, Atty.
Sharp & Bogan
1010 Vermont Avenue, N. W., Washington 5

Mr. B. Nelson Deranian, Lawyer
1100 Bowen Building, Washington 5

GEORGIA

Mr. William D. McLean, Tax Comr.
Southern Railway System
99 Spring Street, S. W., Atlanta

KENTUCKY

Mr. James C. Boyd, President
J. C. Boyd Consultants, Inc.
148 North Upper Street, Lexington

Mr. Herman G. Handmaker, Atty.
713 Marion E. Taylor Bldg., Louisville

Mr. J. E. Mueller, Vice Pres.—Treas.
Peaslee-Gaulbert Corporation
226 North 15th Street, Louisville

Mr. Virgil N. Reiling
Liberty National Bank & Trust Co.
Louisville

MASSACHUSETTS

Mr. S. Guy Cheves, Tax Manager
Stanley Home Products, Inc.
Easthampton

Mr. Roy E. Moor, Teaching Fellow
Harvard University
8 Prescott Street, Cambridge 38

MICHIGAN

Mr. Laurence F. Casey, Atty.
Ford Motor Company
3000 Schaefer Road, Dearborn

Mr. John L. Globensky, Atty.
Gray & Gray
120 Pipestone Street, Benton Harbor

MINNESOTA

Mr. Joseph S. Abdnor, Asst. Atty. Gen.
209 State Office Building, St. Paul 1

Mr. James P. McDonnell, President
Minnesota Taxpayers Association
1645 Hennepin Avenue, Minneapolis 3

Mr. Lloyd F. Wilkes
Tax Research Counsel
Minnesota Taxpayers Association
702 Empire Bank Bldg., St. Paul

MISSOURI

Mr. Clarence V. Burns, Asst. Secy-Treas.
American Zinc, Lead & Smelting Co.
1600 Paul Brown Bldg., St. Louis

NEBRASKA

Mr. Leonard D. Bronder, Research Director
Nebraska Citizens Council
427 Sharp Bldg., Lincoln

NEW JERSEY

Mr. Elmo G. Valle, C.P.A.
126 Market Street, Paterson

NEW YORK

Mr. Bernard Abramson, C.P.A.
51 Chambers Street, Suite 511, New York 7

Mr. Henry J. Dohrmann, Manager
Tax Department
Celanese Corporation of America
180 Madison Avenue, New York 16

Mr. John F. Duffy, C.P.A.
Charles Pfizer & Co., Inc.
11 Bartlett Street, Brooklyn

Mr. Douglas Erskine, Manager
Tax Department
Arabian American Oil Company
505 Park Avenue, New York 22

Anthony H. Henelt, Tax Manager
P. Lorillard Company
119 West 40th St., New York 18

Mr. Robert S. Herman, Economist
New York State Budget Division
State Capitol, Albany

Mr. Jacob M. Holtzman, C.P.A.
57 Lincoln Road, Brooklyn 25

Mr. Charles Klem, Vice Pres.
New York Stock Exchange
11 Wall Street, New York

Mr. K. E. Lachmann
P. O. Box 20
Grand Central Station Post Office, New York

Mr. C. Francis Mahaney
Mahaney & Pontolillo
115 Genesee Street, Utica

Mr. Morris Rauch, C.P.A.
475 Fifth Avenue, New York 17

Mr. Samuel Shechet, C.P.A.
Shechet & Shechet
505 Fifth Avenue, New York 17

Mr. Leo Spandorf, C.P.A.
Kohleriter & Spandorf
113 West 42d Street, New York 36

Mr. Robert C. Sullivan
Kennecott Copper Corporation
161 East 42d Street, New York 17

Mr. Roland S. Tremble, Manager
Tax Section
American Car & Foundry Co.
30 Church Street, New York

OHIO

Mr. Stanley J. Bowers, Deputy Tax Comr.
Ohio Department of Taxation
State Office Bldg., Columbus

Mr. Robert G. Katzenmeyer
212 North De Peyster Street, Kent

PENNSYLVANIA

Mr. Henry C. Beerits
Library, Bureau of Municipal Research
311 South Juniper Street, Philadelphia 7

Mr. Harold M. Covert, Jr.
Mutual Benefit Life Insurance Co.
1142 Hamilton Street, Allentown

Mr. George S. Forde, Revenue Comr.
Department of Collections
City Hall Annex, Philadelphia 7

Mr. F. P. Turner, Jr.
Tax Accountant
Aircraft-Marine Products, Inc.
2100 Paxton Street, Harrisburg

TEXAS

Mr. Kenneth McCalla, General Counsel
Texas Railroad Association
P. O. Box 1023, Austin 66

WISCONSIN

Mr. Don M. Soule
432 Sidney Street, Madison 3

CANADA

Robert B. Dale-Harris, Esq.
McDonald, Currie & Co.
80 King Street, West
Toronto 1, Ontario

Stanley E. Edwards, Esq.
4 Marmion Avenue
Toronto 12, Ontario

J. L. Stewart, Esq., Q.C.
6 Shorncliffe Avenue
Toronto 12, Ontario

Statement of the Ownership, Management, Circulation, etc., Required by the Act of Congress of August 24, 1912, as Amended by the Acts of March 3, 1933, and July 2, 1946

Of *National Tax Journal*, published quarterly at Lancaster, Pennsylvania, for October 1, 1952.

State of California }
County of Sacramento } ss:

Before me, a Notary Public in and for the State and county aforesaid, personally appeared Ronald B. Welch, who, having been duly sworn according to law, deposes and says that he is the Business Manager of the *National Tax Journal* and that the following is, to the best of his knowledge and belief, a true statement of the ownership, management, etc., of the aforesaid publication for the date shown in the above caption, required by the Act of August 24, 1912, as amended by the Acts of March 3, 1933, and July 2, 1946 (section 537, Postal Laws and Regulations), to wit:

1. That the names and addresses of the publisher, editor, managing editor, and business manager are:

Publisher—National Tax Association, P.O. Box 1799, Sacramento 8, California.

Editor—J. Keith Butters, Soldiers Field, Boston 63, Massachusetts.

Managing Editor—None.

Business Manager—Ronald B. Welch, P.O. Box 1799, Sacramento 8, California.

2. That the owner is: National Tax Association, a non-stock corporation, chartered in the District of Columbia, whose principal office is located at 1020 N Street, Sacramento 14, California.

3. That the known bondholders, mortgagees, and other security holders owning or holding 1 per cent or more of total amount of bonds, mortgages, or other securities are: None.

(Signed) Ronald B. Welch, *Business Manager.*

Sworn to and subscribed before me
this 22nd day of September, 1952.

(Signed) Bess L. Bieser,

Notary Public, County of Sacramento,
State of California.

Commission expires January 17, 1954.

NATIONAL TAX ASSOCIATION

Organized 1907 — Incorporated 1930

OBJECT. The National Tax Association is a non-political, non-sectarian, and non-profit-making educational organization. Its object, as stated in its certificate of incorporation, is to educate and benefit its members and others by promoting the scientific study of taxation and public finance; by encouraging research; by collecting, preserving, and diffusing scientific information; by organizing conferences; by appointing committees for the investigation of special problems; by formulating and announcing, through the deliberately expressed opinion of its conferences, the best informed thought and ripest administrative experience available; and by promoting better understanding of the common interests of national, state, and local governments in the United States and elsewhere, in matters of taxation and public finance and interstate and international comity in taxation.

MEMBERSHIPS. The Association welcomes to its membership, for mutual discussion and deliberation, all who may be interested in taxation and public finance generally. Annual dues are: junior memberships for individuals under thirty-five years of age, $5; senior memberships for government agencies and educational institutions and their personnel, $10; senior memberships for other individuals and organizations, $15; sustaining memberships, $100 to $1,000.

PUBLICATIONS. The NATIONAL TAX JOURNAL is published quarterly in March, June, September, and December. PROCEEDINGS of the annual conferences on taxation which are sponsored by the Association are published soon after the meetings. The JOURNAL and the PROCEEDINGS are sent to members without charge. To non-members the price of the JOURNAL is $5.00 per year, single numbers, $1.50. The prices of the PROCEEDINGS vary; that of the 1952 volume is $6.75.

Applications for membership, orders for publications, and general inquiries should be addressed to Ronald B. Welch, Secretary, National Tax Association, P.O. Box 1799, Sacramento 8, California.
